‘When is a Debt Bad or Doubtful in Terms of the Income Tax Act?’

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Abstract

Bad debt deductions and doubtful debt allowances provide relief to taxpayers who would be subject to income tax on amounts accrued to them which may never be received. No definition of a bad or doubtful debt is provided in the Income Tax Act. This dissertation considered current legislation, historical court cases, academic writing and the views expressed by SARS through explanatory memoranda and directives in order to establish when a debt becomes bad or doubtful and the extent of the relief granted. This dissertation also considered the future of the doubtful debt allowance in light of the change of accounting standards from IAS 39 to IFRS 9. There are no specific requirements for a debt to become bad or doubtful. Whether a debt is bad is a factual question taking into account all relevant facts. Whether a debt is doubtful and the extent of the allowance granted is determined by the Commissioner, but that determination must be reasonable. The Commissioner relies on IAS 39 rules of impairment as the starting point for determination of a doubtful debt allowance. IFRS 9 determines impairment in a significantly different manner to IAS 39, abandoning the requirement that a "loss event" must have occurred. Adoption of IFRS 9 will result in a change to the determination of doubtful debt allowances, for example, by reducing the generally accepted rate of 25% of identified doubtful debts or by requiring the taxpayer to compile a list of debts which would have qualified as doubtful under IAS 39.

Keywords

Bad debt, doubtful debt, discretion, IAS 39, IFRS 9, income tax

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1 Introduction

1.1 Background and rationale for research

The *Income Tax Act No. 58 of 1962* ("the Act") defines gross income in the case of a resident as "*the total amount, in cash or otherwise, received by or accrued to or in favour of such a resident.*"[1] A taxpayer must therefore include amounts in gross income not only when cash is received by the taxpayer, but also when an amount is accrued to the taxpayer. Our courts have determined that accrual takes place when the taxpayer becomes unconditionally entitled to an amount. An amount need not be due and payable for it to accrue to a taxpayer.[2]

Where a taxpayer provides goods or services on credit a timing difference will occur. As the sale of goods and services becomes unconditional when the goods or services are provided to the customer, the taxpayer must include the full amount of the sale in their gross income.

Where payment is only made by the consumer after the year of assessment, the taxpayer will bear the burden of taxation before receiving the cash to which they are entitled. This timing mismatch is worsened when debtors default on their debt and the funds are never received. In order to ensure that the taxpayer is not taxed on amounts which are never received, the Act provides a deduction where a debt has become bad and an allowance where it is anticipated that debt will become bad. These sections seem to propose a straightforward answer to the burden of being taxed on sales for which no amount was received, but the application is far from clear. The terms 'bad', 'doubtful' and even 'debt' are not defined in the Act. Consequently, I have observed instances of disputes between the taxpayer and SARS over the requirements for a debt to be doubtful. These disputes include differences in interpretation of what recovery actions the Act requires of a taxpayer, how unlikely recovery should be before a debt may be considered bad and written off, or the amount of the allowance which may be claimed when a debt is doubtful.

Each of these areas of uncertainty has an effect on the taxable income of the taxpayer. A bad debt deduction is 100% of the value of a debt which has been identified as bad, whereas a

[1] *Income Tax Act No. 58* of 1962: section 1, definition of "*gross income*"

[2] *Lategan v CIR 1926 2 SATC 16* and *CIR v People's Stores (Walvis Bay) (Pty) Ltd 1990 52 SATC 9*

doubtful debt allowance provides relief for only a fraction of the doubtful debt.[3] Any difference in classification between bad and doubtful debts has the potential to significantly reduce the relief provided to taxpayers. For most taxpayers any effect on their taxable income will be minor. This is because the doubtful debt allowance merely results in a timing difference, with the doubtful debt allowance claimed in year one added back in year two. However, in industries such as large retailers who allow their clients to make purchases on credit, the number of doubtful debtors and the aggregate value of those debts can be quite substantial. Differences over the classification of bad and doubtful debts, allowance rates and requirements for bad debt recovery would all result in a significant cash flow movements and possibly deprivation of interest income and profits for the taxpayer.[4]

At the time of writing this dissertation a number of changes to legislation governing doubtful debts are underway. Section 18(1)(*j*) of the *Taxation Laws Amendment Act No. 25 of 2015* called for the release of a public notice by the Commissioner detailing criteria by which doubtful debts will be evaluated. The introduction of a set of criteria governing the evaluation of doubtful debts to which the taxpayer can refer into the text of the Act is an opportunity to clarify a number of legal uncertainties. The public notice has not yet been released. The *Taxation Laws Amendment Act No. 17 of 2017* introduced a new subsection, 11(*j*A), which replaces the Commissioner's discretion with fixed percentages when evaluating the doubtful debts of the banking sector. In addition, an upcoming change in the accounting standard governing financial instruments[5], from *International Accounting Standard 39 ("IAS 39")* to *International Financial Reporting Standard 9* (*"IFRS 9"*) will lead to a wide ranging re-evaluation as to how section 11(*j*) relates to amounts disclosed as impaired debtors in a taxpayer's financial statements. How these changes will affect the determination of bad and doubtful debts and the deductions and allowances granted by the Act is uncertain.

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[3] The allowance is at the discretion of the Commissioner, but is usually 25%.

[4] As a doubtful debt allowance must be added back in the year of assessment following the year in which it was claimed there is effectively no tax benefit when the effect of the two years of assessment is taken in aggregate. However, where the taxpayer is required to pay tax in the first year of assessment that taxpayer will be unable to use those funds to invest in expanding their business or investing. The interest from investing or business opportunities foregone due to reduced available funds is the economic cost of the interpretation of the allowance on the taxpayer.

[5] A term which includes debtors.

1.2 Research questions

This dissertation seeks to determine the current legal position regarding bad and doubtful debts by performing a comprehensive review of current legislation, historical court cases, academic writing and the views expressed by SARS through explanatory memoranda and directives. This dissertation will also consider the future of the doubtful debt allowance in light of the change of accounting standards from *IAS 39* to *IFRS 9.* By summarising the current legal position and the areas of dispute, this dissertation aims to answer the following four questions:

1. When will a debt be considered bad?
2. When will a debt be considered doubtful?
3. How is the allowance granted in terms of section 11(*j*) determined and how may the taxpayer challenge this determination?
4. How will the change from *IAS 39* to *IFRS 9* affect the process by which the Commissioner determines the allowance to be granted in terms of a doubtful debt?

1.3 Limitation of scope

This dissertation will focus only on sections 11(*i*) and 11(*j*) of the Act and the proposed section 11(*j*A). There will be no consideration of the effects of a sale of a debtors book. This dissertation will not consider the treatment of bad debts incurred by money-lenders where the amounts loaned constitute the floating capital. These amounts are deducted in terms of the general deduction formula in section 11(*a*) rather than section 11(*i*). This dissertation will not consider the treatment of bad or doubtful debts for Value-added Tax or any other tax purposes. This dissertation will not consider the treatment of bad or doubtful debts in foreign jurisdictions.

The answers to the research questions raised in 1.2 will depend on the factual circumstances faced by the taxpayer. As a result, the findings provided by this dissertation may not be capable of providing certainty in its answers.

This dissertation explores impending changes to the tax legislation. The proposed amendments may still be altered further which may have a significant impact on the content of portions of this dissertation.

1.4 Methodology

This dissertation will follow a doctrinal research methodology. The rules governing bad and doubtful debts will be systematically considered in an attempt to identify how the totality of South African law at present would answer the research questions set out above. As such, this dissertation will consider:

1. South African legislation relating to bad and doubtful debts;
2. South African court cases concerning bad and doubtful debts;
3. South African academic literature, legal commentaries and textbooks on bad and doubtful debts;
4. SARS practice and interpretation notes, explanatory memoranda and sector and directives; and
5. The text, and articles on the application of *IAS 39* and *IFRS 9*.

1.5 Structure of the dissertation

Chapter 2: Bad Debts

Chapter 2 considers the current approach to legislative interpretation set out in *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 2012 (4) SA 593 (SCA). The chapter then considers the language, purpose and context of section 11(i), including a brief historical analysis of the substantive developments in relation to this section. The correct timing of the determination of a bad debt is considered. Finally, the chapter considers when a debt is bad.

Chapter 3: Doubtful Debts

Chapter 3 considers the principles of interpretation and the language, purpose and context of section 11(j) including a brief historical analysis of the substantive developments in relation to this section. The correct timing of the determination of a doubtful debt is then considered.

The chapter considers when a debt is considered to be doubtful. Attention is paid to the distinction between bad and doubtful debts. Finally, the proposed amendment to section 11(j) is summarised and considered.

Chapter 4: The Discretion of the Commissioner and the Taxpayer's rights to dispute

Following the introduction to the concept of the Commissioner's discretion in Chapter 3, Chapter 4 considers the requirement that the allowance granted by the Commissioner adhere to the constitutional right to just administrative action. The *Tax Administration Act No. 28 of 2011* and the *Promotion of Administrative Justice Act No. 3 of 2000* give expression to this right in relation to the granting of a doubtful debt allowance. The relief granted to the taxpayer by these acts is considered. The principles of lawfulness, reasonableness and procedural fairness inherent in just administration are considered in terms of how the allowance in terms of section 11(*j*) may be granted.

Chapter 5: The BASA Directive: An example of the Commissioner's discretion

Chapter 5 evaluates an example of the exercise of the Commissioner's section 11(j). The 17 February 2012 letter issued by SARS to the Chairman of the Banking Association of South Africa ("the Directive") sets out the manner in which the Commissioner will exercise their discretion. The content of the Directive is summarised and evaluated against the legal principles established in the previous chapters. The *Taxation Law Amendment Act No. 17 of 2017* replaces the approach established in the Directive with section 11(*j*A). Chapter 5 summarises the function of section 11(*j*A) and considers how this new approach relates to the legal principles established in previous chapters.

Chapter 6: IFRS 9 and its impact on the allowance for doubtful debts

Chapter 6 considers the impact the change in accounting standard from *IAS 39* to *IFRS 9* will have on the exercise of the Commissioner's discretion in section 11(*j*). This chapter provides an explanation of the *IFRS 9* approach to the impairment of Financial Instruments and the impact that approach will have on the disclosure of doubtful debts in the annual financial statements of a taxpayer. The Chapter then speculates on possible approaches to the exercise of section 11(*j*)'s discretion which may be adopted by SARS in response to the change in accounting standard.

Chapter 7: Conclusion

Chapter 7 will summarise and conclude on the findings of the preceding chapters and highlight areas for further study.

2 Bad Debts

2.1 Introduction

In this chapter, the current wording of section 11(*i*) of the Act is analysed using the principles of interpretation set out in *Natal Joint Municipal Pension Fund v Endumeni Municipality 2012 (4) SA 593 (SCA).* This chapter considers the meaning of the section looking at the language, context and purpose of the provision and the changes made to section 11(*i*) over the past 92 years. The rulings made by South African courts when considering section 11(*i*) are summarised. The correct time for the determination of whether a debt has become bad is considered. Finally, the chapter considers when a debt is bad.

2.2 Interpretation of the Act

2.2.1 Principles of interpretation

The principles applicable when interpreting a statutory provision were recently clarified in *Natal Joint Municipal Pension Fund v Endumeni Municipality*[6] in which Wallis JA said the following:

> *"[18] … The present state of the law can be expressed as follows: Interpretation is the process of attributing meaning to the words used in a document, be it legislation, some other statutory instrument, or contract, having regard to the context provided by reading the particular provision or provisions in the light of the document as a whole and the circumstances attendant upon its coming into existence. Whatever the nature of the document, **consideration must be given to the language used in the light of the ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed** and the material known to those responsible for its production. Where more than one meaning is possible each possibility must be weighed in the light of all these factors. **The process is objective, not subjective**. A sensible meaning is to be preferred to one that leads to insensible or unbusinesslike results or undermines the apparent purpose of the document. Judges must be alert to, and guard against, the temptation to substitute what they regard as*

[6] 2012 (4) SA 593 (SCA): [18]

reasonable, sensible or businesslike for the words actually used. To do so in regard to a statute or statutory instrument is to cross the divide between interpretation and legislation; in a contractual context it is to make a contract for the parties other than the one they in fact made. ***The 'inevitable point of departure is the language of the provision itself', read in context and having regard to the purpose of the provision and the background to the preparation and production of the document.****"* [my emphasis]

The following sections follow the approach suggested, considering section 11(*i*) in terms of the language, context and purpose of the provision. As described in the *Natal Joint Municipal Pension Fund v Endumeni Municipality*[7], the context and language of the section must be considered together with neither predominating over the other.[8] This principle is in line with the dictum of the Constitutional Court in *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs 2004 (4) SA 490 (CC)* which stated that:

"the emerging trend in statutory construction is to have regard to the context in which the words occur, even where the words to be construed are clear and unambiguous."

Therefore, although *Natal Joint Municipal Pension Fund v Endumeni Municipality*[9] does state that the "*inevitable point of departure is the language of the provision itself*", the process of interpretation will not be complete until the context of the section and the purpose of the provision have been considered.

2.2.2 The language of the provision

The current version of section 11(*i*) follows below:

"11. General deductions allowed in determination of taxable income. *– For the purpose of determining the taxable income derived by any person from carrying on*

[7] 2012 (4) SA 593 (SCA)

[8] *SAICA, 2013*

[9] 2012 (4) SA 593 (SCA)

any trade, there shall be allowed as deductions from the income of such person so derived-

(i) the amount of any debt due to the taxpayer which has during the year of assessment become bad, provided such amount is included in the current or was included in previous years of assessment in the taxpayer's income;"

The subsections that follow highlight the salient concepts in the wording of the current legislation.

2.2.2.1 ***'debt due'***

The term 'debt' is defined in the Act for the purposes of section 19 and paragraph 12A of the Eighth Schedule as not including a tax debt as defined in section 1 of the *Tax Administration Act No. 28 of 2011* ("TAA"). The TAA defines a "*tax debt*" as "*an amount referred to in section 169(1)*," Section 169(1) states that "*An amount of tax due or payable in terms of a tax Act is a tax debt due to SARS for the benefit of the National Revenue Fund*." Section 19 and paragraph 12A concern the income tax and capital gains tax consequences of a reduction of debt. Reduction of debt refers to the forgiveness of debt through agreement or unilateral decision and is not applicable where a debt is written down but still kept in the financial statements or is written off by a taxpayer due to the expectation of non-recovery.[10] These definitions therefore confirm only what a debt is not. There is no definition of what a debt is. According to case law, the ordinary meaning of debt is:

'that which is owed or due; anything (as money, goods or services) which one person is under obligation to pay or render to another.'[11]

The term 'debt due' is not defined in section 11 or any other section of the Act. In *CIR v People's Stores (Pty) Ltd 1990 (2) 52 SATC 9* Judge Hefer considered *obiter* the meaning of the term.

[10] *Stiglingh, M., et al, 2016*: 24.8

[11] *Joint Liquidators of Glen Anil Development Corporation Ltd* (*In Liquidation*) *v Hill Samuel* (*SA*) Ltd 1982 (1) SA 103

> *"Counsel for the taxpayer, albeit in a different manner, also relied on the provisions of the Act relating to bad or doubtful debts. Section 11(i) and (j) respectively provide for a deduction in respect of bad and doubtful 'debts due to the taxpayer'. If the Lategan principle were to be applied, so the argument went, the anomalous result would be that debts due to the taxpayer would be subject to the deduction for bad or doubtful debts, whereas debts owing to him but not due would have to be included in his 'gross income' without the benefit of such a deduction. The problem that I have with* ***this submission is that it presupposes that the word 'due' in s 11(i) and (j) means 'due and payable', which is by no means clear****. Admittedly, 'due' often means 'due and payable' when it is said, for example, that a debt is due or when one speaks of the due date of a debt. But I am not convinced that the word was used in that sense here. 'Due and payable' is actually used at least twice in the Act (in ss 7(1) and 91(3)) and in s 7A(2) mention is even made of a salary or pension which 'has become payable'. Taking account also of the Afrikaans version of s 11(i) and (j) ('skulde aan die belatingpligtige verskuldig') it appears to me rather that* ***due was intended to mean 'owing' and no more****."* [my emphasis]

Judge Hefer noted that while "*due*" is often used to mean "*due and payable*" when speaking of a debt, the terms "*due*" and "*payable*" are distinct concepts. When a debt is "*payable*" there exists a right to claim payment; when a debt is "*due*" there exists a right to payment in the future.[12] Section 11(*i*) requires only that the debt be "*due.*" The taxpayer is therefore not required to be in a position to enforce payment.

It has been suggested[13] that the addition of the word '*due*' qualifies the ownership of the debt and that consequently the debt must belong to the taxpayer at the end of the year of assessment. It has further been suggested[14] that where a debt is sold or a taxpayer compromises with one of his debtors, a bad debt deduction cannot be claimed. As the debt would no longer be due to the taxpayer, it is submitted that this approach is correct.

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[12] *Lategan v CIR* 1926 2 SATC 16

[13] *Stiglingh, M., et al, 2016*: 8.37

[14] *Stiglingh, M., et al, 2016*: 8.37

2.2.2.2 ***'which has…become bad'***

The phrase '*which has during the year of assessment become bad'* refers to what is commonly known as a 'bad debt'. The term 'bad debt' does not appear in the section, nor is it used anywhere else in the Act. The term 'bad' is not defined in the Act, nor can it be described as a term of art with a specific legal connotation. In the absence of a defined meaning, a term should generally be given the meaning it bears in the particular trade, business or vocation where that term is used.

1. Black's Law Dictionary defines a 'bad debt*'* as *"an uncollectable debt."*[15]

2. The term 'bad debt' is a commonly used accounting term and is defined in the *Dictionary of Accounting Terms* as '*a debt that, **is assumed,** will never be paid*" and "[a] *debt that has not been paid and has been written off."*[16] [my emphasis]

3. The *Macmillan Dictionary of Accounting* defines a 'bad debt' as "*an amount owing which **is not expected to be received** and is therefore written off either to a bad debts account or to a previously established provision for bad (or doubtful debts)."*[17] [my emphasis]

4. The *Oxford Advanced Learner's Dictionary*[18] and the *Cambridge Dictionary*[19] define a 'bad debt' as '*a debt that is **not likely** to be paid*'. [my emphasis]

As can be seen from many of the definitions quoted above, the ordinary definition of a bad debt contains within it a degree of uncertainty. Determining whether a debt is bad will often involve an element of estimation. What is unclear from both the ordinary definitions and the wording of section 11(*i*) is to what degree the judgement of the taxpayer in situations of uncertainty is permitted.

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15 *Black's Law Dictionary: "bad debt"*

16 *Dictionary of Accounting Terms: "bad debt"*

17 *Macmillan Dictionary of Accounting*: "*bad debt*"

18 *Oxford Advanced Learner's Dictionary: "bad debt"*

19 *Cambridge Dictionary: "bad debt"*

2.2.3 The purpose of the provision

Section 11 of the Act provides the taxpayer with a number of possible deductions against income from carrying on a trade. Generally, an amount falls within a taxpayer's gross income and therefore, its taxable income, if it is received or accrued, that is to say, if the taxpayer acquires an unconditional entitlement to the amount. To subject a taxpayer to income tax on an amount which although accrued will likely not be received would result in an inequity. Section 11(*i*) is directed at alleviating this inequity.[20]

2.2.4 The context of the provision

Bad and doubtful debts were originally dealt with under the same subsection in *Income Tax Act No. 40 of 1925*.[21] When that Act was replaced with the *Income Tax Act No. 58 of 1962*, the treatment of bad and doubtful debts was placed into two separate sections. The amendments to section *11(i)* over the last 92 years are presented in the table below.

Table 1: Amendments to the wording of section 11(i) between 1925 and 2017

Section 11(2)(g) of the Income Tax Act No. 40 of 1925	*The amount of any **debts** due to the taxpayer which are **proved to the satisfaction of the Commissioner** to be bad or doubtful, any deduction in respect of doubtful debts being made according to a value determined by the Commissioner."*
Income Tax Act No. 58 of 1962	*"the amount of any **debts** due to the taxpayer to the extent to which they are **proved to the satisfaction of the Secretary** to be bad, provided such amount is included in the current year of assessment or was included in previous years of assessment"*
Income Tax Amendment Act No. 89 of 1969	*"the amount of any **debts** due to the taxpayer to the extent to which they are **proved to the satisfaction of the Secretary** to be bad, provided such amount is included in the current year of assessment or was included in previous years of assessment (including in the case*

[20] *CIR v Delfos 1933 AD 242*: 257

[21] Section 11(2)(*g*) of *Income Tax Act No. 40 of 1925*

	of a company, years of assessment under any Income Tax Ordinance of the territory) in the taxpayer's income."
Income Tax Amendment Act No. 94 of 1983	***"the amount of any debts due to the taxpayer to the extent to which they are proved to the satisfaction of the Commissioner to be bad, provided such amount is included in the current year of assessment or was included in previous years of assessment in the taxpayer's income."***
Income Tax Amendment Act No. 113 of 1993	*"the amount of any* ***debts*** *due to the taxpayer* ***which have during the year of assessment become bad****, provided such amount is included in the current year of assessment or was included in previous years of assessment in the taxpayer's income."*
Taxation Laws Amendment Act No. 22 of 2012	*"the amount of any* ***debt*** *due to the taxpayer* ***which has during the year of assessment become bad****, provided such amount is included in the current year of assessment or was included in previous years of assessment in the taxpayer's income."*

The progression of section 11(*i*) shows only two major changes: the removal of the Commissioner's discretion in determining the extent of bad debts claimed and the relatively smaller change of the plural 'debts', to the singular 'debt'. The 2012 change of 'debts' to 'debt' was stated in *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2012* to be merely a terminology change taking place across the entire act. It would thus be inappropriate to draw any conclusion from the change of plural to singular as it was not the intention of the legislature to make a substantive change to the functioning of the section.

The removal of the Commissioner's discretion in 1993 is a more substantial change. Prior to the 1993 amendment the taxpayer was required to prove to the satisfaction of the Commissioner that a debt was bad. The Commissioner was in effect granted a discretion to determine whether evidence provided by the taxpayer was sufficient. The difficulty in challenging an exercise of discretion can be clearly seen in *Income Tax Case 93* 1927 3 SATC 239(U):

> *"The Commissioner had a discretion and that discretion had been delegated, as was authorised under the Act, to this official.* ***The Court had to be satisfied by unequivocal evidence that that official had not applied his mind*** *to the subject in terms of the Act…He had given his evidence, and that evidence satisfied the Court quite clearly that he had applied his mind to the problem and exercised his discretion fairly, the Court could not say to the Commissioner "You have exercised your discretion wrongly and the figure you have allowed is wrong."* ***The discretion had been properly exercised and the court could not interfere****."* [my emphasis]

The strict approach to the application of the Commissioner's discretion demonstrated in the above quote was softened later.[22] The 1993 amendment means the Commissioner is expected to make an objective evaluation of whether the debt has become bad, based on the facts. However, as our courts have not provided us with any firm rulings on the characteristics of a bad debt, we are still left with uncertainty. Practically, this amendment may make it easier to dispute a ruling of the Commissioner; where previously the taxpayer was required to prove that the Commissioner had exercised their discretion inappropriately, the taxpayer need now only prove that the debt was bad, a less onerous burden to discharge.

2.3 When should the determination of whether a debt has become bad occur?

The wording of section 11(*i*) is aligned with the concept of tax as an annual event, referring to debts which have "*during the year of assessment become bad*."[23] Therefore, if at the end of a particular year of assessment it is determined that an amount which accrued during the current or a previous year of assessment is bad, the taxpayer will be allowed to deduct the amount. This concept was expressed in *Caltex Oil (SA) Ltd v SIR 1975 (1) SA 665 (A)* as follows:

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[22] The ability of modern courts to evaluate the substance of an exercise of the Commissioner's discretion is discussed in 4.4 below.

[23] Section 11(*i*) of *Income Tax Act* No. 58 of 1962

> *"It is clear from these provisions that income tax is assessed on an annual basis in respect of the taxable income received by or accrued to any person during the period of assessment, and determined in accordance with the provisions of the Act. In determining the taxable income of a person carrying on any trade in any year of assessment there is, in terms of sec. 11 (a), deductible from such person's income the expenditure actually incurred by him in the production of the income during that year of assessment. (Sub-Nigel Ltd., v Commissioner for Inland Revenue, 1948 (4) S. A. 580 (A. D.) at p. 589).* ***It is only at the end of the year of assessment that it is possible, and then it is imperative, to determine the amounts received or accrued on the one hand and the expenditure actually incurred on the other during the year of assessment.*** *(Cf. Port Elizabeth Electric Tramway Co. Ltd. v Commissioner for Inland Revenue, 1936 C. P. D. 241 at p. 244, and Commissioner for Inland Revenue v Delfos, 1933 A. D. 242 at p. 257)."* [my emphasis]

Income Tax Case 592 1945 14 SATC 243 held that bad debts are to be claimed in the year in which the taxpayer finally regards the debts as bad.[24] In *CIR v Delfos* 1933 AD 242 it was held that whether a debt is bad or not must be decided at the time when the debt is claimed as a deduction and according to the then existing financial circumstances of the debtor.[25] It is SARS' practice to allow a taxpayer to determine bad debts when the taxpayer's financial statements are drawn up.[26] It is submitted that the appropriate timing for the determination of whether a debt is bad should take place at the time of the preparation of the income tax return as stated *CIR v Delfos.*[27] However, it is also submitted that a distinction should be drawn between determinations based on information providing insight into conditions as at the end of the year of assessment and information illuminating conditions which arose after year end. Only the former should be used in the determination of bad debts. Information about conditions arising after the end of the year of assessment will not be applicable as that information would relate to debts which become bad in the succeeding year of assessment.

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[24] *Income Tax Case 592* 1945 14 SATC 243: 246

[25] *CIR v Delfos* 1933 AD 242*:* 257

[26] *Stiglingh, M., et al,* 2016: 8.5

[27] See *CIR v Delfos* 1933 AD 242 at 243

This approach is in line with the accounting treatment of events taking place after the end of the financial period.[28] By requiring a taxpayer to claim bad debts in the year in which they occur, the reality of the taxpayer's financial situation at year end is correctly reflected in its return. SARS is also protected from the taxpayer delaying the recognition of a bad debt until a time at which it is beneficial for the taxpayer.[29]

In *Anderton and Halstead, Limited v Birrell (Inspector of Taxes) [1932] 1 K.B. 271*, which dealt with a section of the English Act on bad debts and was cited with approval in *CIR v Delfos*, it was held that:

> *'…what the statute requires therefore is an **estimate** to what extent a debt is bad, and this is for the purpose of a profit and loss account. **Such an estimate is not a prophecy to be judged by after events**, but a valuation of an asset de praesenti upon an uncertain future to be judged with regard to its soundness as an estimate **upon the then facts and probabilities.**'*[30] [my emphasis]

From the above quote we see that should the financial position of a debtor improve such that a debt which was previously claimed as a bad debt can now be said to be likely to be repaid, the original classification of the debt as bad is not incorrect and will not be required to be reversed.[31] When a bad debt is recovered in a subsequent year of assessment it is included in the gross income of the taxpayer for the year of assessment during which it has been received.[32] As noted previously, this recoupment provision acknowledges that the original estimate of bad debts made by the taxpayer may subsequently be proved to be incorrect. It therefore follows that the point at which a bad debt is determined is therefore not at the

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[28] *International Accounting Standard 10 - Events after the reporting period*

[29] *Zulman, RH., Preiss, M., Silke, J.*: [A:B8] *Bad Debts – Hoarding of*

[30] *CIR v Delfos* 1933 AD 242: 258 to 259

[31] *CIR v Delfos* 1933 AD 242*:* 258

[32] Section 8(4)(*a*) of Income Tax Act No. 58 of 1962

point when non-recovery is certain, but rather at the date of submission of the return for the year of assessment in which the taxpayer concluded that the debt was bad.[33]

2.4 Determining whether a debt is bad

The courts have refrained from providing a definitive list of factors which must be considered before a bad debt deduction is allowed. While SARS has in correspondence with taxpayers at times asserted that all appropriate steps to collect the debt (either through in-house or external agency efforts) must have been taken before a debt is regarded as bad, no such requirement is present in case law. In *Income Tax Case 93*[34] it was held that it is a question of fact as to whether or not a debt is bad. No general principles can be given and each case must be viewed in the light of its own particular set of facts. It is submitted that it is also not a requirement that the bad debt should have been recorded in the financial statements of the taxpayer. As discussed in 2.3, the appropriate time for the determination of a bad debt is the time at which the return is submitted. *Income Tax Case No. 1284 (1978) 41 SATC 45 (R)* considers how this issue of timing provides insight to whether an entry in the financial statements of a taxpayer is necessary for a bad debt to be claimed. In that case Judge Pringle said: [35]

> *"There is apparent support for the respondent's contention, that failure to enter as a bad debt in appellant's books the sum of $72 000 on or before 31 March 1976 preclude deduction, in Caltex Oil (SA) Ltd v SIR (1975) 37 SATC 1 (AD) at 11, in fin, where Botha JA said that* ***it is only at the end of the year of assessment that it is possible, and then it is imperative, to determine the amounts received or accrued on the one hand and the expenditure actually incurred on the other during the year of assessment****. However, the main authority to which his Lordship referred was CIR v Delfos 1933 AD 242 at 257. It will be observed that in that case Curlewis JA referred to the drawing up*

33 As the debt must have been included in the taxpayer's income before it may be claimed as bad, were a debt to become bad before it had been included in the taxpayer's income the wording of the Act would prevent the debt from ever being claimed as bad. Such a situation could occur where the foreign debt becomes bad while subject to section 9A of the Act (Blocked foreign funds).

34 *(1927) 3 SATC 239*

35 (1978) 41 SATC 45 (R): 49

of the profit and loss account and balance sheet for a year of assessment as the stage when a debt is written off. It seems unlikely that had he disagreed with that view Mr Justice Botha would not have said so. Further in the Caltex Oil case at 13 Mr Justice Botha indicated that an entry in books of account in relation to a bad debt which had become incorrect by reason of fluctuations in the rates of exchange did not govern; on the contrary ***the true figure at the end of the year not entered in the books was the operative figure****. In my view* ***it is not a requirement of s 15(2)(a) of our Act that a bad debt should have been entered in a taxpayer's book of account during the accounting period or year of assessment in respect of which deduction is claimed****."* [my emphasis]

It is submitted that Judge Pringle was correct when he stated that entering an impairment in the books of account of the taxpayer during the year of assessment is not a requirement for a bad debt deduction. Rather, whether a debt is bad or not is a factual question which will be answered based on the specific set of circumstances of the taxpayer. It should be noted therefore that while impairing a debt in either the accounting books or the debtor system of the taxpayer is not a requirement for a debt to be considered bad, the failure to do so would be a strong indicator that the taxpayer does in fact view the debt as recoverable. In *Income Tax Case No. 1284*[36], for example, while the court was not satisfied that entries were made in the taxpayer's book before year end, the court was satisfied that

"at least ***a provisional decision*** *that a loss had been sustained which would be reflected in the appellant's accounts* ***had been made*** *by the appellant's managing director and* ***manifested in discussions with one or more other officials*** *of the [taxpayer]."*[37] [my emphasis]

While it is submitted that this approach is correct, it must be acknowledged that in the absence of clear indicators there exists uncertainty as to when a debt is more than merely doubtful and may be claimed as a bad debt.

[36] (1978) 41 SATC 45 (R)

[37] (1978) 41 SATC 45 (R): 49

Historical bad debt recoveries or subsequent recoveries of other taxpayers are not key requirements in determining the status of a debt. It is the specific circumstances of the taxpayer's specific debtors which must be evaluated by the taxpayer when determining whether those debts are bad. Judge Maritz in *Income Tax Case 93* (1927) 3 SATC 239 (U) stated that:

> *"The Court was **only dealing with the affairs of one particular taxpayer**, and sec 11(2)(g) must be read in the light of the affairs of that taxpayer, and the decision of **the Court must be influenced by no outside considerations**. The section seemed to be perfectly clear. First of all the taxpayer, before he could be allowed to deduct any debts at all, must prove that they were bad. In other words, if the Commissioner was satisfied that they were bad an automatic deduction took place. Further, there were some debts which could not be exactly classed as bad, but might be classed as doubtful. There the onus was upon the taxpayer to satisfy the Commissioner that if not the whole at least a certain proportion of these debts was doubtful."* [my emphasis added]

In the extract above it is clear that Judge Maritz is of the opinion that the prohibition on "*outside considerations*" is equally applicable to the determination of bad and doubtful debts. This judgment provides support for the denial of statistical models when determining whether a debt is bad. However, the manner in which both bad and doubtful debts were determined in 1927 when *Income Tax Case 93*[38] was decided is significantly different from modern statistical methods. Early provisioning methods did not have access to computerised account histories which enabled them to identify long-term trends. In determining whether a debt was bad, focus was placed on whether certain actions, such as the exhaustion of internal recovery methods, had been performed to the debt and not on the probability of recovering the debt. This could result in situations where accounts are unable to move to the next category of delinquency due to the inability of the taxpayer to fulfil the criteria. Provision is usually made only for debts in late stage delinquency, ignoring the possibility for new accounts to rapidly progress to a state of irrecoverability.[39]

[38] (1927) 3 SATC 239 (U)

[39] *Scallan, G.* 1990

In 1962[40] and later in 1978[41] a statistical technique known as Markov Chains was suggested for us in commercial lending and the determination of doubtful debts. Markov Chains are probabilistic models used to determine the likelihood of movement from one state to another, for example, from the movement of a debtor from one level of delinquency to another. It is not within the scope of this dissertation to discuss to the functioning of such a model. Nevertheless, it is important to bear in mind that the modern approach to bad and doubtful debt prediction is substantially more advanced than the older provisioning methods.

2.5 Conclusion

In this chapter the concept of a bad debt was considered. It was noted that while bad and doubtful debts were originally dealt with in the same section, modern legislation separated the concepts into two sections. It is submitted that this separation was an indication that bad and doubtful debts should not be treated in a similar manner. A difference in the treatment of bad and doubtful debts was confirmed when amendments to the Act removed the discretion of the Commissioner in the determination of whether a debt is bad.

The correct time to evaluate whether or not a debt is bad was determined to be at the point of submission of the period's tax return. When considering what factors should be taken into account when weighing up whether or not a debt is bad, it was found that all relevant factors should be considered and that no specific events are requirements for a debt to be considered bad. It is submitted that it is unlikely that our courts will interpret section 11(*i*) as requiring that it is absolutely certain that the debt will not be paid or recoverable. Indeed, it would seldom be possible to do so. It is submitted that the correct approach to the objective test mentioned above would be to determine whether, in the light of all relevant facts and circumstances, there is no reasonable likelihood that the debt will be paid or will be recovered by taking reasonable steps for recovery. An inaccurate deduction in terms of section 11(*i*) would not necessarily have a permanent effect. If the debt was subsequently to be paid, the

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40 *Cyert, RM., Davidson, HJ., Thompson, GL.,* 1962

41 *Corcoran, A.W.* 1978

amount would be included in the taxpayer’s income as a recovery or recoupment in terms of section 8(4)(*a*).

It was also found that the factors should be applicable to the specific debts in question and not to trends drawn from other taxpayers or debtors. The efficacy of such a limitation considering modern financial model-driven approaches was questioned.

3 Doubtful Debts

3.1 Introduction

In Chapter 3, as in Chapter 2, current wording of section 11(*j*) of the Act is discussed using the principles of interpretation clarified in *Natal Joint Municipal Pension Fund v Endumeni Municipality.*[42] The meaning of the section is considered by inspection of the language, purpose and context of the section and the changes made to section 11(*j*) over the past 92 years. The rulings made by the South African courts when considering section 11(*j*) are summarised. Finally, the chapter considers when a debt is doubtful.

3.2 Interpretation of the Act

3.2.1 Principles of interpretation

As noted in Chapter 2, the principles applicable when interpreting a statutory provision were clarified in *Natal Joint Municipal Pension Fund v Endumeni Municipality*[43] in which Judge Wallis said:

> *"The 'inevitable point of departure is the language of the provision itself', read in context and having regard to the purpose of the provision and the background to the preparation and production of the document."*

In line with this decision and the approach taken in Chapter 2, Chapter 3 will consider the language, context and purpose of section 11(*j*) in order to interpret the meaning of the section.[44]

3.2.2 The language of the provision

The current wording of the section follows:

> *"**11. General deductions allowed in determination of taxable income.** – For the purpose of determining the taxable income derived by any person from carrying on*

[42] *2012 (4) SA 593 (SCA): 18*

[43] *2012 (4) SA 593 (SCA): 18*

[44] *SAICA, 2013*

any trade, there shall be allowed as deductions from the income of such person so derived-

(j) an allowance as may be made each year by the Commissioner in respect of so much of any debt due to the taxpayer as the Commissioner considers to be doubtful, if that debt would have been allowed as a deduction under any other provisions of this Part had that debt become bad: Provided that such allowance shall be included in the income of the taxpayer in the following year of assessment;"

3.2.2.1 ***'debt due'***

The term 'debt due' is used in section 11(*j*) as it is in section 11(*i*). It is presumed that a statute will be interpreted so as to be internally consistent.[45] Where the same word has been employed it will be understood to carry the same meaning. For a discussion of the terms 'debt' and 'debt due' refer to 2.2.2.1.

3.2.2.2 ***'as the Commissioner considers doubtful'***

The word 'doubtful' and the term 'doubtful debt' are not defined in the Act. As was the case with 'bad debt', the term 'doubtful debt' does not appear in the section, nor is it used anywhere else in the Act. The word 'doubtful' is not defined in the Act, nor can it be described as a term of art with specific legal connotation. In the absence of a defined meaning a term should generally be given the meaning it bears in the particular trade, business or vocation where the term is used.

1. The ordinary definition of 'doubtful' refers to an event "*of uncertain outcome or result*."[46]

2. The Oxford Dictionary of English defines 'doubtful' as "*not known with certainty*."[47]

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45 The common law principle of interpretation *ex visceribus actus* ("*from the bowels of the Act*"), means that legislation should be read as a consistent whole.

46 *Dictionary.com: "doubtful"*

47 *Oxford Dictionary of English: "doubtful"*

3. The Cambridge Dictionary states that "*if a situation is doubtful, it is unlikely to happen or to be successful*."[48]

A doubtful debt is therefore, much like a bad debt, a debt the recovery of which is uncertain. *Income Tax Case 93* quoted below states that there is a greater degree of uncertainty around doubtful debts.

> *"In other words, if the Commissioner was satisfied that they were bad an automatic deduction took place. Further, there were some debts* ***which could not be exactly classed as bad, but might be classed as doubtful****."* [my emphasis]

A doubtful debt is therefore a debt of which there is more uncertainty of recovery than a bad debt. How that difference in uncertainty is determined and at what point a debt becomes uncertain enough to be a bad debt is not apparent from legislation or case law.

3.2.2.3 ***'allowance… made each year by the Commissioner'***

In contrast to section 11(*i*), the wording of section 11(*j*) has maintained the requirement that the allowance granted be to the extent that the Commissioner considers the debt to be doubtful. While the language used by the courts appears to indicate that they would be reluctant to contradict the assertions by the Commissioner as to what is and is not a doubtful debt,[49] the Commissioner's discretion is explicitly subject to objection and appeal to the tax court in terms of section 3(4) of the Act.[50]

On close inspection, section 11(*j*) contains two separate areas of discretion for the Commissioner. The Commissioner is first required to consider whether a debt due is in fact doubtful (discussed above). Where the Commissioner is of the opinion that the debt is

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48 *Cambridge Dictionary: "doubtful"*

49 Judge Maritz in *Income Tax Case 93* (1927) 3 SATC 239(U) had the following to say in this regard: '*if he had applied his mind to the problem and exercised his discretion fairly, the Court could not say to the Commissioner "You have exercised your discretion wrongly and the figure you have allowed is wrong."*' Judge Nathan conveyed a similar sentiment *in Income Tax Case 273* (1933) 7 SATC 232(U): "*The first objection raised to the argument adduced on behalf of the appellant is that the* onus *lies on the appellant to satisfy the Commissioner that the debts are bad or doubtful, and in ordinary cases that would seem to be a conclusive objection."*

50 "*3(4) Any decision of the Commissioner under the following provisions of this Act is subject to objection and appeal in accordance with Chapter 9 of the Tax Administration Act, namely – (b) …section 11(j)…"*

doubtful they are then required to grant an allowance. The extent of the allowance granted and the manner in which that allowance must be calculated is not provided in the section. The courts have ruled[51] that the Commissioner must apply their mind to the allowance granted, however in practice the Commissioner will often simply grant an allowance of 25% of specifically identified doubtful debts[52] to the taxpayer. The Commissioner's discretion is discussed in 3.3.1.

3.2.3 The purpose of the provision

Section 11(*j*) and its predecessor section 11(2)(*g*), like section 11(*i*), seek to prevent the inequity which arises where a taxpayer is subject to income tax on an amount unlikely to be received. Although the purpose of the provision is the same as section 11(*i*), the relief provided for doubtful debts differs from that provided for bad debts. While the full amount of a bad debt was allowed as a deduction, only a portion of a doubtful debt (a "*value determined by the Commissioner*" and later "*an allowance as may be made each year by the Commissioner*") would be granted as an allowance. The difference in approach was due to the lower degree of uncertainty of recovery. As the inequity was less likely to arise it was deemed unnecessary for the taxpayer to be protected for the entire amount. Instead taxpayer and Commissioner were both partially insulated, the taxpayer from tax on an amount which may not be received and the Commissioner from an amount which was already accrued to the taxpayer and which may in fact still be received.

3.2.4 The context of the provision

As stated in 2.2.3, the provision of a tax allowance for doubtful debts was initially included together with the allowance for bad debts in Income Tax No. 40 of 1925. Since its inclusion as a standalone section in the Income Tax Act No. 58 of 1962, the section 11(*j*) allowance for doubtful debts has maintained its essential characteristics. There remains an allowance which may be granted by the Commissioner on debts which the Commissioner is satisfied are

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51 *Income Tax Case 93* (1927) 3 SATC 239(U)

52 *Zulman, RH., Preiss, M., Silke, J.:* [A:B7] *Bad and doubtful debts – Doubtful debts*

doubtful. The amendments to section 11(*j*) over the past 92 years are presented in the table below.

Table 2: Amendments to the wording of section 11(j) between 1925 and 2017

Section 11(2)(g) of the Income Tax Act No. 40 of 1925	*The amount of any debts due to the taxpayer which are proved to the satisfaction of the Commissioner to be bad or doubtful, any deduction in respect of doubtful debts* ***being made according to a value determined by the Commissioner.”***
Income Tax Act No. 58 of 1962	***Such an allowance as may be made*** *each year by the Secretary in respect of such debts due to the taxpayer as he considers to be doubtful: Provided that such allowance shall be included in the income of the taxpayer in the following year of assessment, and for that purpose any allowance granted in terms of paragraph (h) of sub-section (2) of section eleven of the Income Tax Act, 1941, in respect of the year of assessment ended on the thirtieth day of June, 1961,shall be deemed to be an allowance which was made in terms of this paragraph*
Income Tax Amendment Act No. 89 of 1969	***Such an allowance as may be made*** *each year by the Secretary in respect of such debts due to the taxpayer as he considers to be doubtful: Provided that such allowance shall be included in the income of the taxpayer in the following year of assessment, and for that purpose –* *Any allowance granted in terms of section 11(2)(h) of the Income Tax Act, 1941, in respect of the year of assessment ended on the thirtieth day of June, 1961; and* *Any allowance granted to any company in terms of section 11(2)(k) of the Income Tax Ordinance, 1961 (Ordinance No. 10 of 1961), of the territory, in respect of the year of assessment, ended on the thirtieth day of June 1968,*

	shall be deemed to be an allowance which was made in terms of this paragraph
Income Tax Amendment Act No. 94 of 1983	*Such an allowance as may be made each year by the Secretary in respect of such debts due to the taxpayer as he considers to be doubtful: Provided that such allowance shall be included in the income of the taxpayer in the following year of assessment.*
Income Tax Amendment Act No. 31 of 2005	*An allowance as may be made each year by the Commissioner in respect of so much of any debts due to the taxpayer as the Commissioner considers to be doubtful,* ***if those debts would have been allowed as a deduction under any other provisions of this Part had they become bad.*** *Provided that such allowance shall be included in the income of the taxpayer in the following year of assessment.*
Taxation Laws Amendment Act No. 22 of 2012	*An allowance as may be made each year by the Commissioner in respect of so much any debt due to the taxpayer as the Commissioner considers to be doubtful, if* ***that debt*** *would have been allowed as a deduction under any other provisions of this Part had* ***that debt*** *become bad; Provided that such allowance shall be included in the income of the taxpayer in the following year of assessment;*

There have been some additions and refinements, but unlike the amendments to the sections dealing with bad debts, none have substantially altered the manner of the operation of the section. The doubtful debt allowance has from 1969 been required to be included in the taxpayer's income in the following year, changing the section from a once off determination of the status of a debt, to a yearly review of the creditworthiness of the taxpayer's debtor base. This approach drastically reduced the potential harm to SARS as the tax effect of assessments of doubtful debts later determined to be recoverable would be reversed in the following period. From 2015 a debt on which an allowance is claimed must have been able to be allowed as a deduction under any other provision of the Act should that debt become bad. This amendment means that, as in section 11(*i*), only debts which have previously been included as taxable income for the taxpayer will qualify as doubtful debts. The change of 'debts' to 'debt' was stated in the Explanatory Memorandum on the Taxation Laws Amendment Bill, 2012 to be merely a terminology change taking place across the entire Act. It would thus be inappropriate to draw any conclusion from the change of plural to singular as it was not the intention of the legislature to make a substantive change to the functioning of the section.

3.3 When should the determination of whether a debt is doubtful occur?

The primary authority for when a doubtful debt allowance must be determined is *CIR v Delfo*s.[53] While this case concerned a bad debt at the time the case was decided allowances for bad and doubtful debts were contained within the same section. No distinction was made between the two concepts. The appropriate timing for the determination of bad debts was discussed in 2.3. It is submitted that the same considerations are applicable to the determination of doubtful debts. Unlike bad debts however, Section 11(*j)* has no requirement that the debt must have become doubtful during the year of assessment. As such, it is submitted that the taxpayer is entitled to use all information available at submission of the tax return to ascertain whether a debt is doubtful.

3.4 Determining whether a debt is doubtful

3.4.1 Distinguishing doubtful debts from bad debts

Much of our case law dealing with bad and doubtful debts comes from the 1920's and 1930's[54]. These cases were decided under *Income Tax Act No. 40 of 1925* ("the previous Act"). Section 11(2)(*g*) of this act contained the provisions dealing with deductions for bad and for doubtful debts. *CIR v Delfos*[55] illustrates the lack of a clear distinction between the concepts

53 *1933 AD 242*

54 For example, *Income Tax Case 93 (1927) 3 SATC 239(U), Income Tax Case 139 (1929) 4 SATC 212(U), Income Tax Case 183 (1930) 5 SATC 262(U)* and *Income Tax Case 273 (1933) 7 SATC 232(U).*

55 1933 AD 242

of a bad and a doubtful debt in case law decided under section 11(2)(*g*). In this Appellate Division case the court had to consider whether a debt owing to the taxpayer "*accrues to or in favour of*" the taxpayer during a year in which it has been proved to the satisfaction of the Commissioner to be a bad debt or whether it would only accrue when the debt was received by the taxpayer. The finding of the court on this matter (that the amounts did accrue to the taxpayer in the year in which his salary was credited to him) is not in doubt. However, the court's *obiter* comments and assumptions surrounding the treatment of bad and doubtful debts can provide insight into the court's understanding of these terms.

The taxpayer, a director of the South African Iron and Steel Industrial Corporation Limited, was not paid his full salary for the period 1923 to 1929. The outstanding balance was paid to the taxpayer in 1930. The Commissioner received a letter from the Secretary of the South African Iron and Steel Industrial Corporation Limited the last paragraph of which read as follows:

> *"Owing to the financial position of the company it is possible that Mr Delfos may never receive the moneys due to him as managing director, but in the event of his being paid the whole or any part of the company undertakes to notify the Income Tax Commissioner, Pretoria, of the amount thereof.[56]"*

For the period 1923 to 1929 the Commissioner assessed the taxpayer on only the amounts which were paid over to him. It was the opinion of the special court and the Appellate Division that the only way in which the Commissioner could have assessed the taxpayer on the lesser, received amounts was if the outstanding amounts were considered bad debts. According to the assenting opinion of Judge Curlewis:

> *"They were treated as bad debts and not as doubtful debts because no valuation was made of them as doubtful debts,* ***the whole amounts having been deducted from the***

[56] 1933 AD 242

'income' *of the respondent as deductions under sec. 11(2)(g) so as to ascertain his 'taxable income' within the meaning of sec. 7(1).*[57]*"* [my emphasis]

The court quoted with favour the following dictum from *Anderton and Halstead, Limited v Birrell*[58]:

> *"**What the statute requires therefore is an estimate to what extent a debt is bad**, and this is for the purpose of a profit and loss account. Such an estimate is not a prophecy to be judged by after events, but a valuation of an asset* de praesenti *upon an uncertain future to be judged with regard to its soundness as an estimate upon the then fact and probabilities."*[59] [my emphasis]

When we consider the ruling of the Appellate Division, the above *dicta* and the content of the letter sent to the Commissioner we can make the following observations:

1) The Appellate Division was of the opinion that where the entire value of a debt was claimed in full as a deduction, it must be a bad debt. This is in contrast to a doubtful debt allowance which would only relate to a portion of the total debt.
2) It is possible for a debt to be considered a bad debt while there is still a possibility of the debt being paid. Complete certainty of non-recovery (e.g. after liquidation of the company) is not required.

The first point is logical. A doubtful debt provides relief in relation to the probability of recovery. A 0% probability of recovery is not a requirement for a bad debt, but would certainly qualify as a bad debt were it to be established.

It is the second point where the difficulty in differentiating the concepts of bad and doubtful debts appears. In my opinion it is both logical and appropriate that complete objective certainty of irrecoverability would be too high a standard of proof to provide the taxpayer with suitable relief. While it is appropriate for bad debts to require a higher likelihood of non-

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57 1933 AD 242

58 [1932] 1 K.B.: 282

59 [1932] 1 K.B.: 282

recoverability than doubtful debts, there exists no clear dividing line between the two concepts. It is submitted that the facts of this case did not reflect a situation where a deduction for bad debts was appropriate. While the company was in financial difficulty, it had credited the debt due to the taxpayer in their books, the debt remained a liability for the company at the time of the 'write off' and the wording of the letter to the Commissioner admitted only that "*Mr. Delfos may never receive the moneys due to him.*" It is submitted that while the *dictum* from *Anderton and Halstead, Limited v Birrell*[60] (quoted above) is a sensible rule, its application in the instant case was inappropriate. Perhaps the Commissioner sought to save face for an employee of the Commissioner who had incorrectly applied the principle of accrual. This absence of a clear distinction in early case law between bad and doubtful debts is unfortunate as the concepts are treated very differently, the full amount of a bad debt allowed as a deduction, but only a portion of a doubtful debt granted as an allowance at the discretion of the Commissioner.

3.4.2 The discretion of the Commissioner to grant a doubtful debt allowance

The manner in which the Commissioner is to apply their discretion was considered by the courts in *Income Tax Case 273 (1933) 7 SATC 232*. The taxpayer claimed a certain amount as a doubtful debt deduction. In prior years of assessment, the taxpayer had claimed (and the Commissioner allowed), a doubtful debt allowance of greater than 25% of the doubtful debts identified. In the instant year of assessment, the Commissioner allowed only 25% of the total statement of doubtful debts due to the appellant. No evidence was provided to the court with regard to the history of the company's bad debts. Instead the Commissioner relied on the assertion that it was the onus of the taxpayer to satisfy the Commissioner that debts have become bad or doubtful and as authority for the figure of 25% the Commissioner referred to *Barnes' Income Tax Handbook*, p.78 which stated that:

> *"An allowance in respect of doubtful debts may be made 'according to a value determined by the Commissioner.' (Sec 11(2)(g)). A list of debts regarded as doubtful*

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60 *1932, 1 K.B.: 282*

must be supplied. The allowance will never exceed 25 per cent of the list doubtful debts – arbitrary amounts not being allowed."

While the court agreed it was correct that the taxpayer bore the *onus* of satisfying the Commissioner of the extent to which an allowance should be granted,[61] the court found that the Commissioner, in simply granting an allowance of 25% of the debtors identified irrespective of the merits of the debts in question, had not applied his mind. The appeal was allowed, the assessment set aside and the matter referred back to the Commissioner for further investigation and re-assessment.

Income Tax Case 273[62] thus established in law that the Commissioner must 'apply his mind' to the determination of a doubtful debt allowance and cannot simply rely on an arbitrary figure when making that determination. However, it remains SARS' practice to grant a doubtful debt allowance in the amount of 25% of identified doubtful debtors.[63] This simplistic approach is most likely due to the lack of capacity available to the functionaries of SARS to properly investigate and 'apply their minds' to the nature and circumstances of each individual doubtful allowance claimed by a taxpayer. It is certainly true that this would be an onerous task. Dr Manfred Nathan, K.C in *Income Tax Case 273*[64] however, had little sympathy for this state of affairs. In concluding the judgement of *Income Tax Case 273*[65] he stated that:

> *"**The Act does not talk about an arbitrary standard or percentage**, but says that there must be a value, and under these circumstances, if it is thought that this is inconvenient, then the Legislature must be applied to alter the Act. While the Act stands we can only carry into effect what was intended by the Legislature."* [my emphasis]

In the 84 years since this judgment was handed down the Legislature has indeed been applied to alter the Act. However, the manner in which the current section 11(*j)* describes the

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[61] *Tax Administration Act No. 28 of 2011 section 102. Burden of Proof*

[62] *(1933) 7 SATC 232*

[63] *de Koker, AP., Williams, RC.* 2017*:* 8.38

[64] (1933) 7 SATC 232 (U)

[65] (1933) 7 SATC 232 (U)

discretionary powers of the Commissioner is very similar to the equivalent section at the time the judgment in *Income Tax Case 273*[66] was delivered. It is submitted that the wording of the Act has not been substantially changed and that there remains a responsibility on the Commissioner to apply his mind to the circumstances of each taxpayer and each debtor. It is further submitted that the SARS practice of allowing a flat rate of 25% of identified doubtful debtors contradicts the judgement in *Income Tax Case 273*.[67] The advent of modern statistical models referred to in 2.4 have made it even less appropriate for a flat rate of 25% to be granted to a taxpayer. The extent of the Commissioner's discretion and the taxpayer's power to challenge that discretion will be discussed in Chapter 4.

3.4.3 The Special Formula

Where the nature of the taxpayer's business is such that it is not practicable to collect a list of specifically identified debtors, the SARS allows the use of the special formula[68] given as:

> *"Y = M x N*
>
> *Where:*
>
> *Y is the calculated reserve for doubtful debts that will be allowed by the SARS;*
>
> *M is the average of bad debts written off less the bad debts recovered over a five year period (including the current year of assessment), expressed as a percentage of the annual average credit turnover (excluding cash sales) for the period; and*
>
> *N is the outstanding debtors' balances at the close of the current year of assessment less the bad debts written off during that period*."

The special formula provides a simplistic method for approximating doubtful debts. The total debtors at year end are multiplied by the average net bad debts over the past five years over the average credit sales from the past five years. There are a number of shortcomings in this

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66 (1933) 7 SATC 232 (U)

67 (1933) 7 SATC 232 (U)

68 *de Koker, AP., Williams, RC.* 2017*:* 8.38

formula, including its inflexibility in accounting for different categories of debtors carrying different degrees of risk and the fact that the formula is based solely on historical information. It is possible that the creditworthiness of customers five years prior could be substantially different to the current year clients (due perhaps to a change in clientele or a downturn in the economy). The special formula does not take these factors into account. Current circumstances will take five years before they cease to have an effect on the extent of the doubtful debt allowance claimed.

Additionally, the formula is tied to the amount of bad debts granted. As noted in Chapter 2.4, SARS may require the exhaustion of all methods of recovery before a bad debt deduction is granted. The rationale often given by the Commissioner is that these debts should rather be classified as doubtful debts resulting in a significantly decreased allowance of 25%. This strict application will have a knock on effect on the special formula. The nature of the formula means that the stricter the requirements in granting a bad debt deduction the lower the total doubtful debt allowance.

3.5 Amendments to section 11(j)

The Commissioner may be aware of the weakness of this position as an amendment to section 11(*j*) proposed by the *Taxation Laws Amendment Act No. 25 of 2015*[69] with an effective date to be determined by the Minister of Finance in the *Gazette*[70] which will replace the reference to the Commissioner's discretion with a set of rules to be followed in calculating the doubtful debt allowance. The proposed wording reads as follows:

> *"**11. General deductions allowed in determination of taxable income.** – For the purpose of determining the taxable income derived by any person from carrying on any trade, there shall be allowed as deductions from the income of such person so derived-*
>
> *(j) an allowance as may be made each year in respect of so much on any debt due to the taxpayer as is considered doubtful according to criteria set out in this regard in a*

[69] Section 18(1)(*i*)

[70] Date not yet determined.

public notice issued by the Commissioner, if that debt would have been allowed as a deduction under any other provisions of this Part had that debt become bad: Provided that such allowance shall be included in the income of the taxpayer in the following year of assessment[71]*;"*

The *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2015* did not contain any reference to the amendment to section 11(*j*). The proposed amendment may release the Commissioner from the burden of applying their mind by implementing a more formulaic approach governed by strict predetermined parameters. However, the substitution of a discretionary approach for a set of inflexible rules will not provide sufficient relief for taxpayers. The criteria have not yet been published so it is not yet possible to pass judgement. It is likely that any published criteria will include an opportunity to make presentations to the Commissioner supporting an alternative basis for the doubtful debt allowance much like the clause included in the Letter to the Banking Association of South Africa on the Treatment of Doubtful Debts dated 17 February 2012 (refer to Annexure A).

3.6 Conclusion

No definition of a doubtful debt is provided by the Act. The ordinary meaning of the word indicates that a doubtful debt is a debt which is less certain to be recovered than a bad debt. The appropriate time to determine whether a debt is doubtful is upon submission of the tax return for that year of assessment. The interpretation of the proper manner in which to apply the doubtful debt allowance was settled during a time where it was sufficient to provide taxpayers with the opportunity to identify specific debtors in danger of defaulting on their commitments. It was of no concern whether a debt was bad or doubtful; the same section governed both situations. The lack of a need to differentiate between the two terms led to the terms being used imprecisely and in some places interchangeably. While *Income Tax Act No. 58 of 1962* was introduced and the two terms split into separate sections, the case law providing the interpretations of the terms bad and doubtful debts remained largely the same;

[71] Proposed amendment: Para. (*j*) to be substituted by s. 18(1)(*i*) of Act No. 25 of 2015 with effect from a date determined by the Minister of Finance in the *Gazette.*

imprecise all-encompassing pronouncements of a judiciary who had had no need to create a firm dividing line.

At the same time, advances in financial management practices have provided taxpayers with more accurate predictions of future defaulters. Despite this increase in accuracy, the 25% default allowance remains despite case law requiring the Commissioner apply their mind. Finally, it was noted that the amendment to section 11(*j*) aims to establish criteria against which doubtful debts will be judged. At the time of writing no indication has been provided as to what these criteria might be.

4 The Discretion of the Commissioner and the Taxpayer's Rights to Dispute

4.1 Introduction

Due to the inability of static legislation to account for the myriad complexities which arise in practice, a degree of discretion is sometimes granted to those required to implement the law.

> *"A public officer has discretion whenever the effective limits on his power leaves him* ***free to make a choice*** *among possible causes of action or inaction."*[72] [my emphasis]

Section 11(*j*) is one such section where a public officer is given the freedom to make a choice between possible responses. The Act contains no indication of how the allowance should be determined. This chapter considers the remedies available to the taxpayer who wishes to dispute a determination made by the Commissioner in the light of the three most relevant pieces of legislation: the *Constitution of the Republic of South Africa No. 108 of 1996* ("the Constitution"), the *Promotion of Administrative Justice Act No. 3 of 2000* ("PAJA") and the *Tax Administration Act No. 28 of 2011* ("TAA").

4.2 The constitutional right to just administrative action

The Constitution is the supreme law of the land. Legislation which contradicts the Constitution may be declared unconstitutional and void either in whole or in part.[73] *Pharmaceutical Manufacturers Association of SA: In re: ex parte President of the Republic of South Africa* 2000 (2) SA 674 (CCC) held that the judicial review of public power must flow from the Constitution.

> *"The common law principles that previously provided the grounds for judicial review of public power have been subsumed under the Constitution, and in so far as they might continue to be relevant to judicial review, they gain their force from the Constitution."*[74]

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[72] *Davis, KC.:* 1972

[73] *Constitution of the Republic of South Africa No. 108 of 1996: Section 2*

[74] *Pharmaceutical Manufacturers Association of SA: In re: ex parte President of the Republic of South Africa* 2000 (2) SA 674 (CCC) para 33

The exercise of the Commissioner's discretion must therefore be aligned to the values of the Constitution. Contained within the Constitution is the Bill of Rights, "*the principal source of substantive constraints on public power*."[75] And within the Bill of Rights is the right to just administrative action:

> *"Section 33 (1) Everyone has the right to administrative action that is lawful, reasonable and procedurally fair.*
>
> *(2) Everyone whose rights have been adversely affected by administrative action has the right to be given written reasons.*
>
> *(3) National legislation must be enacted to give effect to these rights, and must*
>
> > *(a) provide for the review of administrative action by a court or, where appropriate, an independent and impartial tribunal;*
> >
> > *(b) impose a duty on the state to give effect to the rights in subsections (1) and (2) and*
> >
> > *(c) promote efficient administration."*

It is only in exceptional cases that this right to just administrative action is relied upon as a free-standing concept. Section 33(3) of the Constitution calls for national legislation to be enacted to give effect to the right to just administrative action and in the vast majority of circumstances that legislation will be the avenue through which administrative justice will find effect.

4.3 The Tax Administration Act

The primary expression of administrative justice in the field of tax law is the TAA. Section 3(4) of the Income Tax Act sets out a list of 'decisions' which are subject to Chapter 9 of the TAA. Included in that list are decisions made under section 11(*j*), that is, the granting of a doubtful debt allowance. Chapter 9 Part B of the TAA sets out the procedural steps to be taken when objecting to a decision made by the Commissioner. The TAA details the timing and form of each step in an objection process culminating in an appeal to the tax court.[76]

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75 *Currie, I., de Waal, J.* 2005: 23

76 *TAA*: Section 107 (1) and Section 115

Section 129(2) of the TAA makes available three remedies to the tax court in such an appeal:

> *"(a) confirm the assessment or 'decision';*
>
> *(b) order the assessment or 'decision' to be altered; or*
>
> *(c) refer the assessment back to SARS for further examination and assessment."*

There is some uncertainty as to whether the court is entitled to alter a decision made by the Commissioner where the Commissioner has properly applied their mind.[77] When a taxpayer takes a 'decision' on appeal to a tax court, the tax court does not function as a court of appeal, but rather as a court of review.[78] In *CIR v Da Costa* 1986 (3) SA 768 (A)[79] it was held that as the Tax Court is a court of revision it follows that:

> *"in cases involving the exercise of a discretion by the Commissioner, which is taken to **the Special Court** on appeal, it **is called on to exercise its own original discretion**."*[80]

This is in direct contrast to the ruling in *Income Tax Case 1295*[81] where it was held that where the Commissioner has made a *bona fide* exercise of their discretion the Tax Court would only be entitled to interfere where that exercise of discretion was unreasonable. It is submitted that the correct approach would be to follow the High Court ruling put forward in *CIR v Da Costa*[82] that a Special Court, such as a tax court, is required to exercise its own discretion and should not pay special deference to the decision made by the Commissioner, even where the Commissioner has applied their mind. A Tax Court reviewing an exercise of discretion may also consider facts which had not previously been considered by the Commissioner as was noted *in CSARS v Capstone 556 (Pty) Ltd* 2016 (4) SA 341 (SCA):

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[77] It should be kept in mind that section 102 of the TAA places the burden of proving a decision made by the Commissioner is incorrect on the taxpayer.

[78] *Rand Ropes (Pty) Ltd v CIR* 1944 AD 142, 13 SATC 1.

[79] 1986 (3) SA 768 (A) at 774.

[80] *Commissioner for Inland Revenue v Costa* (14/1984) [1985] ZASCA 32; [1985] 2 All SA 335 (A) (24 May 1985) quoted with approval *Rand Ropes (Pty) Ltd v Commissioner for Inland Revenue* 1944 AD 142 in turn quoting with approval *Baily v Commissioner for Inland Revenue* 1933 AD 220.

[81] *1983 42 SATC 19*

[82] *1986 (3) SA 768 (A)*

> *"Unlike the position obtaining* ***in Special Court*** *where* ***a decision is given on facts which may not have been considered by the Commissioner****, this Court hears an appeal from a Special Court on the record of the proceedings in that Court."* [my emphasis]

Should the matter be taken on appeal to the High Court or beyond, other principles would apply. The High Court is always entitled to interfere with the Tax Court's decision where the Tax Court was biased in its judgement, did not act for substantial reason or had "e*xercised its decision capriciously or upon a wrong principle*."[83] However, the further powers of an appeal court depend on the whether the discretion exercised was broad or narrow.

The distinction between broad and narrow discretions was covered in *Media Workers Association of SA v Press Corporation of SA* 1992 (4) SA 791 (A),[84] cited with approval and applied in *MTN Service Provider (Pty) Ltd v Afro Call (Pty) Ltd* [2007] SCA 97 (RSA).[85] A narrow or strict discretion is a choice between different alternatives, while a broad or loose discretion involves consideration of a number of different factors. Where the discretion is a discretion in the broad or loose sense, the powers available to the court of appeal are less constrained. The court of appeal will have "*a wider scope…for the matter to be reconsidered on the merits*",[86] while a strict discretion will be unassailable unless the decision was based on incorrect facts or legal principles.[87]

It is submitted that the discretion afforded to the Commissioner is a broad discretion and the reticence to interfere with the Commissioner's allowance demonstrated in cases such as *Income Tax Case 93*[88] and *Income Tax Case 273*[89] is now ill-founded. Tax Courts and High Courts may consider the merits of the allowance awarded and may substitute that allowance

83 *ex parte Neethling* 1951 *(4) SA 331 (A) at 335*

84 *1992 (4) SA 791 (A)*: 796H-I and 800E-G

85 *[2007] SCA 97 (RSA):* 11

86 *[2007] SCA 97 (RSA)*

87 *Giddey NO v JC Barnard & Partners* 2007 (2) BCLR 125 (cc): [22]

88 *(1927) 3 SATC 239(U)*

89 *(1933) 7 SATC 232(U)*

with an amount they determine. The principles against which the allowance granted must be evaluated are considered in 3.4.

4.4 The Promotion of Administrative Justice Act

PAJA is the means by which the constitutional right to just administrative action that is lawful, reasonable and procedurally fair flows in terms of general administrative law. Each of these requirements will be considered further in the context of PAJA.

PAJA is applicable to "*administrative actions*." "*Administrative actions*" are defined as

"*any decision taken, or any failure to take a decision, by-*

> *An organ of state, when-*
>
> *… (ii) exercising a public power or performing a public function in terms of any legislation; or …"*

PAJA defines decisions as "*decisions of an administrative nature*." The PAJA definition of administrative action explicitly excludes "*the legislative functions of Parliament, a provincial legislature or a municipal council*" and "*the judicial functions of a judicial officer of a court*."[90] It is submitted that decisions of an administrative nature are decisions connected to the day-to-day implementation of legislative policy and the formation of policy within the framework allowed by primary legislation. Therefore the exercise of the Commissioner's discretion in both determining whether a debt is doubtful and in determining the extent of the allowance will qualify as decisions of an administrative nature.

The decision must be undertaken in terms of an empowering provision. The term "*empowering provision*" means "*a law, a rule of common law, customary law, or an agreement, instrument or other document in terms of which an administrative action is purportedly taken.*" The Income Tax Act would constitute a law in terms of which an administrative action is taken.[91]

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[90] PAJA: definition of '*administrative action' (b) (dd) and (ee)*

[91] Regulations issued by the Commissioner under an empowering provision would also constitute administrative action. This is the view expressed in *Minister of Health and McIntyre NO v New Clicks South Africa (Pty) Ltd and Others* 2006 (2) SA 311 (CC): *"It is true that the making of regulations is not referred to in subparagraphs (a) to*

4.4.1 Procedural Fairness

PAJA enshrines the requirement that administrative action be procedurally fair in section 3(1):

> *"3. Procedurally fair administrative action affecting any person*
>
> *(1) Administrative action which materially and adversely affects the rights or legitimate expectations of any person must be procedurally fair."*

The disallowance by the Commissioner of a deduction claimed by the taxpayer would have an adverse effect on the taxpayer's rights and would thus be required to be "*procedurally fair.*" What procedural fairness entails is dependent on the circumstances of each case.[92] It includes - but is not limited to - adequate notice, reasonable opportunity for representations, a clear statement of administrative action, adequate notice of any right of review or internal appeal and adequate notice of the right to request reasons for a decision.[93] This dissertation will not consider the requirement of procedural fairness further, as this dissertation is not concerned with how SARS interacts with the taxpayer, but rather with how SARS is required to determine the extent of the allowance.

4.4.2 Lawfulness

Lawfulness is the requirement that the decisions of an administrator be in line with the law and should be supported by authority in law. Decisions made outside of the law will be invalid.[94] PAJA gives expression to the concept of lawfulness by detailing in section 6 grounds, specific and general which would enable judicial review.[95] The exercise of the discretion granted by section 11(*j*) would constitute lawful action.

(f). But the reference in the main part of the definition to "any decision of an administrative nature" and in the general provision of subparagraph (g) to "doing or refusing to do any other act or thing of an administrative nature" brings the making of regulations within the scope of the definition." Both the exercise of a discretion by the Commissioner as well as Regulations issued by SARS (as in the amendment to section 11(*j*) would therefore constitute administrative action.

92 PAJA: section 3 (2)(a)

93 PAJA: section 3 (2)(b)

94 *Currie, I., de Waal, J.* 2005: 672

95 *Currie, I., de Waal, J.* 2005: 673

4.4.3 Reasonableness

The concept of constitutional reasonableness was considered in *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs and Tourism and Others* 2004 (4) 490 (CC) where Judge O'Reagan said:

> *"Often a power will identify a goal to be achieved, but will not dictate which route should be followed to achieve that goal. In such circumstances* ***a court should pay due respect to the route selected by the decision-maker****. This does not mean however that where the decision is one which will not reasonably result in the achievement of the goal or which is not reasonably supported on the facts or not reasonable in the light of the reasons given for it, a court may not review that decision.* ***A court should not rubber-stamp an unreasonable decision simply because of the complexity of the decision or the identity of the decision-maker****."*[96] [my emphasis]

For a decision to be reasonable it must therefore be supported by facts and result in the achievement of the goal of the legislation. The constitutional right to administrative action which is "*reasonable*" finds expression in two separate sections of PAJA, section 6(2)(*f*)(*ii*) and section 6(2)(*h*). These subsections are set out below:

> *"6(2) a court or tribunal has the power to judicially review an administrative action if-*
> *(f) The action itself*
> *(ii) is not* ***rationally*** *connected to-*
> *(aa) the purpose for which it was taken;*
> *(bb) the purpose of the empowering provision;*
> *(cc) the information before the administrator; or*
> *(dd) the reasons given for it by the administrator*
> *…*
> *(h) the exercise of the power or the performance of the function authorised by the empowering provision, in pursuance of which the administrative action was*

[96] *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs and Tourism and Others 2004 (4) SA 490 (CC)*

purportedly taken, ***is so unreasonable*** *that no reasonable person could have so exercised the power or performed the function"*

The presence of two separate subsections, the first dealing with rationality and the second with reasonability, contributes to the view that rationality and reasonability are conceptually distinct. This does not, however, mean that there is no overlap between the two tests.

Rationality refers to the "*connection made by the administrative decision-maker between the material properly available to him and the conclusion he or she eventually arrived at*."[97] The existence of rationality is a low bar to clear as the Commissioner need only prove that there was a link between the information available and the conclusion reached, absent of any consideration of proportionality. Reasonableness includes the concept of proportionality not found in rationality.[98] Where any administrative action is not made rationally or reasonably a court may review that action in terms of PAJA. The section 11(*j*) allowance must therefore be rationally and reasonably connected to the purpose of the section. The allowance granted must be rationally connected to the purpose of providing relief to the taxpayer who is taxed on amounts which may not be received. The allowance granted must also have a degree of proportionality. It is submitted that this means that where courts evaluate the content of a decision to award a doubtful debt allowance made by the Commissioner the court must ensure that that decision was reasonable. Reasonableness, it is submitted, means that the allowance must, as far as possible, equate to historical rates of recovery. Where the provision for doubtful debts established by the taxpayer has proven over time to be accurate or conservative it is submitted that it would be reasonable for the Commissioner to grant an allowance equivalent to that provision. Where circumstances differ from prior periods the Commissioner would be entitled to reduce the allowance granted by a reasonable amount. What is reasonable depends on the factual situation of the taxpayer.

4.5 Conclusion

97 *Carephone v Marcus NO and others* (JA52/98) [1998] ZALAC 11 (1 September 1998): 37, confirmed in *Sidumo v Rustenburg Platinum Mines Ltd* 2008 (2) BCLR 158 (CC)

98 *Currie, I., de Waal, J.* 2005: 677

The Constitutional right to just administrative action requires any exercise of discretion to be procedurally fair, lawful and reasonable. The TAA provides the means by which a taxpayer may challenge a discretionary decision made by the Commissioner. Chapter 9 of the TAA sets out the steps to be taken when appealing a decision such as that made by the Commissioner in section 11(*j*). The Tax Court and the High Court have the power to alter the decision of the Commissioner.

The exercise of the discretion in section 11(*j*) is an administrative action and is subject to PAJA. PAJA provides expression to the Constitutional right to just administrative action. In evaluating the allowance granted by the Commissioner, the courts must evaluate the decision in terms of whether that action is procedurally fair, lawful and reasonable.

The discretion will be procedurally fair where the requirements of the TAA have been followed. The discretion will be lawful where it was exercised in terms of the Income Tax Act. The discretion is reasonable where it is rationally connected to the purpose of the section and contains an element of proportionality. A section 11(*j*) allowance should therefore provide relief for taxpayers taxed on amounts which may not be received and that relief should, where possible, be proportional to the actual amount of revenue not received. In many instances this amount can be determined through reliance on historical figures.

5 The BASA Directive: An example of the Commissioner's discretion

5.1 Introduction

On 17 February 2012 SARS issued a letter to the Chairman of the Banking Association of South Africa ("The Directive"). The Directive was sent with the intention of setting out the manner in which the Commissioner will exercise the discretion afforded them in section 11(*j*) of the Income Tax Act as it relates to banks. The Directive is applicable only to banks. However, in detailing how the Commissioner intends to apply the discretion granted by section 11(*j*) to banks in particular, the Directive is one of the few public documents to elucidate the Commissioner's interpretation of the general principles of section 11(*j*) applicable to all taxpayers. The Directive also provides insight into the Commissioner's understanding of the interaction between section 11(*j*) and the International Accounting Standard (in particular International Accounting Standard 39 – Financial Instruments: Measurement and Recognition ("IAS 39").

The Directive will be superseded by the inclusion of section 11(*j*A) in the Income Tax Act[99] and the IAS 39 will be replaced by International Financial Reporting Standards 9 – Financial Instruments ("IFRS 9"[100]). Nevertheless, the Directive highlights the Commissioner's understanding of the workings of the Commissioner's discretion in section 11(*j*) and the interaction of accounting standards with section 11(*j*) both of which will continue to be applicable to all taxpayers.

This chapter seeks to use the methodology put forward by SARS in the Directive to investigate the interpretation of section 11(*j*) taken by SARS and whether it finds accord with our understanding of the section gleaned from the principles of legal interpretation and South African case law as set out in the preceding chapters of this dissertation. This chapter discusses the content of the Directive and its relation to these legal principles. The chapter then discusses the proposed section 11(*j*A) which will take the place of the Directive in

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99 *Taxation Laws Amendment Act No. 17 of 2017: section 19*. The section came into effect on 1 January 2018 and applies in respect of years of assessment commencing on or after that date.

100 *IFRS 9* has an effective date of 1 January 2018 and applies to years starting on or after that date.

regulating the doubtful debts of the banking industry. This amendment is the first legislative response to the change to IFRS 9.

5.2 The Directive

The Directive is a letter to the Chairman of the Banking Association of South Africa and is applicable only to banks. The Directive sets out the manner in which banks must calculate doubtful debt allowances in order for the allowances to be accepted by the Commissioner. Despite being applicable only to banks, the Directive provides insight into the Commissioner's interpretation of the general principles applicable to all taxpayers calculating doubtful debt allowances.

5.2.1 Introduction

In the introductory paragraphs, the Commissioner states that the reason for the issue of the Directive is to detail the "*manner in which the Commissioner will exercise the discretion contained in section 11(j) … as far as it relates to banks.*"[101] After stating the purpose of the Directive, the Commissioner delves into what is the primary concern of the Directive, the interaction between the Accounting Standard and the Income Tax Act:

> *"It is recognized that section 11(j) makes provision for an allowance for debtors in general and not only debtors, the amounts of which, were previously included in income. This creates a beneficial position.* ***As a general rule any special dispensation must be applied strictly and monitored closely*** *and should be limited* ***to make provision only in circumstances where it can be reasonably determined that the debt is truly doubtful or the loss has in fact already been incurred*** *on a particular debt or portfolio of debts and only to the extent that the loss, if written off in the future, will qualify for deduction."* [my emphasis]

It is likely that the Directive is here referring to the following statement in *Ernst v Commissioner for Inland Revenue* 19 SATC 1:

[101] *The BASA Directive*: 1

"The Courts, in dealing with taxing Acts, will not presume in favour of any special privilege of exemption from taxation. Said Lord Young in Hogg v Parochial Board of Auchtermuchty… 'I think it proper to say that, in dubio, I should deem it the duty of the Court to ***reject any construction of a modern statute which implied the extension of a class privilege of exemption from taxation****, provided the language reasonably admitted of another interpretation."* [102] [my emphasis]

It is submitted that, where interpreting legislation, it is no longer a general rule that a special dispensation be applied strictly. Instead, the legislation should be interpreted based on the ordinary wording and the context of the section.[103] The Directive is therefore incorrect where it states that the allowance should be strictly interpreted. The Directive continues:

In this regard the International Reporting Standard ("IAS 39") seeks to determine the appropriate credit provision for accounting purposes. ***This provision is to be based on objective evidence of a past event (or events) that represents an "incurred loss"*** *(or losses). The standard requires* ***an assessment of what has actually occurred, rather than either future events or all eventualities.****"*[104][my emphasis]

The difference between "circumstances where it can reasonably be determined that the debt is truly doubtful or the loss has in fact already been incurred" from the first quote, which the Commissioner states is required by section 11(j) and the "incurred loss" required by IAS 39 in the quote above, is the crux of the Directive.

5.2.2 Financial accounting for credit provisions

The next subheading of the Directive describes *IAS 39*, the three types of impairment provisions used by banks (incurred but not reported ("IBNR"), portfolio specific impairments ("PSI") and specific impairments) and the extent to which each of these categories reflect debts which are doubtful. The impairment in *IAS 39* is based on "*incurred loss events*[105]",

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102 *The BASA Directive: 3*

103 *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA)

104 *The BASA Directive: 3*

105 *IAS 39: 63*

objectively observable occurrences which affect the recoverability of a financial asset. When an incurred loss is identified the future cash flows are estimated and the carrying value of the asset is reduced. These estimations will require the entity to make a subjective assertion as to the extent of future cash flows. The extent to which anticipated losses can be attributed to a specific debt or subset of debts is the basis for the three impairment provision types.

IBNR losses are losses for which objective evidence of an impairment event exists, but there is as yet no objective evidence of the impact of that impairment event at account level. The taxpayer has no way to accurately determine the amount of losses incurred and an estimate of the loss must therefore be made. Where a financial asset has not been found to be individually impaired, that asset is grouped together with other financial assets of similar credit characteristics and the impairment loss estimated for the group as a collective.[106] Under *IAS 39*, the IBNR allowance, even on the collective level, requires the existence of an incurred loss. Foreseeable credit losses unsupported by objective evidence are not disclosed on the financial statements and do not form part of an entities impairment losses.[107] Statistical models, such as the Markov Chains mentioned in 2.4, may be employed in order to determine the total IBNR losses for the period.

PSI losses are anticipated losses on loans for which objective evidence of the impairment of that loan is now present, but where the loan has not yet gone into default.

Specific impairment losses are anticipated losses on loans for which objective evidence of the impairment of that loan is present and where the loan is in default or close to being in default.

All categories of impairment therefore result from objective evidence of a loss event in terms of *IAS 39*. Objective evidence is described in IAS 39 paragraph 59.[108]

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[106] *IAS 39: 64*

[107] *IAS 39: 63*

[108] "*Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the holder of the asset about the following loss events: (a) significant financial difficulty of the issuer or obligor; (b) a breach of contract, such as a default or delinquency in interest or principal payments; (c) the lender, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider; (d) it becoming probable that the borrower will enter bankruptcy or other financial reorganisation; (e) the disappearance of an active market for that financial asset*

Paragraphs 23 and 24 of the BASA Directive set out SARS' objection to the accounting methodology detailed in the *IAS 39*.

> *"Whilst IAS 39 sets out a sound accounting methodology for purposes of determining a more accurate provision for doubtful debts from an "incurred loss" perspective",* ***the term "incurred loss" has a different meaning from an income tax point of view****."*[109][my emphasis]

Our courts have made sure to emphasise a distinction between accounting principles and the interpretation of the Act. *Stellenbosch Farmers' Winery Limited v CSARS* 2012 (5) SA 363 SCA quoted with approval *Secretary for Inland Revenue v Eaton Hall (Pty) Ltd* 1975 (4) SA 953 which had stated that:

> *"accounting practice cannot override the correct interpretation of the provisions of the Act and their application to the facts of the matter."*[110]

The Directive follows this separation of accounting and tax law and distinguishes between an "*incurred loss*" for accounting purposes and for tax purposes. While it is not clear from the Directive as to the reason the term "*incurred loss*" is discussed, the term not appearing in section 11(*j*), it may be that the Commissioner is indicating that while the presence of an "*incurred loss*" is a requirement for an IAS 39 impairment, that "*incurred loss*" should not be equated with "*losses actually incurred*" referred to in section 11(*a*). It is submitted that SARS is merely stating that acceptance that an amount meets the requirements of *IAS 39* does not

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because of financial difficulties; or (f) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including: (i) adverse changes in the payment status in the payment status of borrowers in the group (e.g. an increased number of delayed payments or an increased number of credit card borrowers who have reached their credit limit and are paying the minimum monthly amount); or (ii) national or local economic conditions that correlate with defaults on the assets in the group ((e.g. an increase in the unemployment rate in the geographical area of the borrowers, a decrease in property prices for mortgages in the relevant area, a decrease in oil prices for loan assets to oil producers, or adverse changes in industry conditions that affect the borrowers in the group)."

[109] *The BASA Directive: 23*

[110] *2012 (5) SA 363 (SCA):* 35

mean that it would also meet the requirements of section 11(*a*). It is submitted that this is correct.

5.2.3 Income tax legislation: Section 11(j) and SARS practice: past

The Directive quotes section 11(*j*) and refers to SARS' practice before the issue of the Directive. The Directive refers to a "*general practice … that allows taxpayers to claim 25% of a list the doubtful as an allowance* [sic]."[111] Previous SARS' practice was to allow a "*substantially higher provision on debts considered by the bank as bad and irrecoverable although not yet written off or removed from the banking systems.*"[112] The debts on which this substantially higher doubtful debt provision were claimed had to have been "*considered by the bank, on bona fide grounds, to be bad and irrecoverable in terms of internal audit, external audit and other procedures. The percentage was determined based on, but not limited to, past recovery rates*."[113] The following two points should be highlighted:

5.2.3.1 ***An allowance greater than 25%***

The mere fact that an allowance of 25% of listed doubtful debts has become general practice does not mean that such an approach is supported by legislation or case law. To the contrary, courts have rejected the blanket application of an allowance of 25% of listed doubtful debts where the Commissioner has not considered the specific circumstances of the taxpayer.[114] It is submitted that the Commissioner's previous approach of granting to a taxpayer bank an allowance based on the taxpayer's past recovery rates and other relevant information meets the requirement set out in *Income Tax Case 273*[115] that there be an application of the Commissioner's mind to the specific facts of the taxpayer's situation. It is submitted that this approach is the correct approach for all taxpayers.

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[111] *The BASA Directive: 20*

[112] *The BASA Directive: 20*

[113] *The BASA Directive: 21*

[114] *Income Tax Case 273 (1933) 7 SATC 232 (U)*

[115] *(1933) 7 SATC 232 (U)*

5.2.3.2 ***"Not yet written off or removed from the banking debt systems"***

In my opinion, the assertion by the Commissioner that "*a substantially higher provision*" is only justified where the debt is "*considered by the bank, on bona fide grounds to be bad and irrecoverable*" is less theoretically sound. It is submitted that where a debt has been determined to be bad and irrecoverable, it should more properly be claimed as a bad debt under section 11(*i*). However, it appears that SARS is of the opinion that a bad debt must be "*written off or removed from the banking debt systems*" before it may be claimed as a bad debt. It is submitted that this approach is incorrect. As discussed in 2.3 there are no specific requirements which must be met before a debt may be written off as bad. It is submitted that whether a debt has been written off in the accounts or removed from the banking system of the taxpayer is merely a factor which must be considered when determining whether or not a debt is bad.

5.2.4 SARS Practice: Effective 2011 year of assessment

It was noted in the introductory paragraphs that accounting and tax principles are conceptually different. Nevertheless, considering that it is impracticable for the Commissioner to evaluate the individual doubtful debt allowances of each taxpayer, the Commissioner details their intention to use IAS 39 as the starting point for their evaluation of doubtful debts:

> *"…in order to facilitate a practical solution, the Commissioner will use the discretion, as provided in section 11(j), in* ***adjusting the IAS 39 impairment for tax purposes****…In principle, the greater the extent of estimation involved in computing the IAS 39 provision, the greater is the subjectivity and hence the lower is the amount of such IAS 39 allowance that the Commissioner could then expect to permit for tax purposes."*[116]

The above quote highlights the interaction between the impairment provision created by IAS 39 and the impairment allowance granted by the Commissioner. The Commissioner states that they are adopting a "*more conservative approach in establishing appropriate*

[116] *The BASA Directive: 24*

percentages"[117] to be used in calculating the allowance. The reason given by the Commissioner for the caution shown when approaching the taxpayers' estimation is the inherent subjectivity in making those estimations:

> *"Factors taken into account include mainly **the degree of subjectivity required by banks in estimating future expected cash flows**, such as identifying macroeconomic events and associating these with incurred losses at a portfolio level, identifying the relevant objective evidence of impairment, together with the potential errors in judgement and the need for mathematical assumptions."*[118] [my emphasis]

It is therefore more appropriate to say that the Commissioner's percentage adjusts for an expected inaccuracy, *"the potential errors of judgement and the need for mathematical assumptions*", of the taxpayer's estimation. The rate of allowance granted for each category of debts is as follows:

> *"27.1 25% of the IBNR impairment provision;*
> *27.2 80% of the PSI and specific impairment provision;*
> *27.3 100% of the specific impairment provision provided a valid and accurate split can be distinguished from the PSI provision."*[119]

This approach is defensible where it is possible for the taxpayer to provide support to the Commissioner for the taxpayer's doubtful debt calculation and to then be granted a more favourable allowance. This opportunity to motivate for a different allowable percentage "*based on evidence from past experience*" is provided for by paragraph 25 of the Directive. Without this opportunity for the taxpayer to present the individual facts and circumstances of their specific situation, any prescribed amendments to an already existing standard would be just as mechanistic and inappropriate as the direct adoption of an accounting standard. The Commissioner would not have applied their mind unless the individual facts and circumstances of the taxpayer have been reviewed. Where a taxpayer does not bring forward

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117 *The BASA Directive: 26*

118 *The BASA Directive: 26*

119 *The BASA Directive: 27*

supporting information the Commissioner is justified in accepting this as tacit admission that no such facts and circumstances exist. By setting out the general approach to be followed, but allowing deviations from this approach where appropriately supported, it is submitted that the Commissioner has correctly applied the discretion in section 11(*j*).

While it is not explicitly stated in section 11(*j*), by relying on *IAS 39* the Commissioner asserts their opinion that a debt must have suffered a loss event before a doubtful debt allowance may be claimed. Where a loss event is required statistical models and reference to industry norms will not be sufficient evidence to support that a debt is doubtful. This approach has support in case law. *Income Tax Case* 93[120] (discussed at 2.2.4) requires that each debtor be considered on its own facts and that the mere fact that the taxpayer operates in an industry with a high percentage of default on debts is not sufficient evidence on which to claim a doubtful debt allowance. It is submitted that this approach is no longer appropriate given the increased accuracy of statistical models. The introduction, of *IFRS 9*, an accounting standard in which no loss event is required before impairment takes place will introduce uncertainty as to whether the Commissioner still requires a loss event before a doubtful debt allowance is granted. The impact of *IFRS 9* is discussed in Chapter 6.

The Directive also specifically excludes the time value of money when calculating the doubtful debt allowance.

5.2.5 Suspended interest and general

The Directive states that suspended interest will form part of a taxpayer's gross income and will be subject to the calculation of the doubtful debt allowance detailed above. All consumer debts are subject to the *National Credit Act No. 34 of 2005* ("the National Credit Act"). It is a requirement of the National Credit Act that where payments have been received by the taxpayer those payments must first be allocated to interest before it is allocated to the principal debt.[121] Where interest will be levied on a debt which has been classified as doubtful

[120] (1927) 3 SATC 239 (U)

[121] *National Credit Act No. 34 of 2005*: section 126 (3) *A credit provider must credit each payment made under a credit agreement to the consumer as of the date of receipt of the payment, as follows: (a) Firstly, to satisfy any due or unpaid interest charges; (b) secondly, to satisfy any due or unpaid fees or charges; and (c) thirdly, to reduce the amount of the principal debt*.

the application of the National Credit Act may have a considerable impact on the calculation of doubtful debt.

As an example, consider a loan the principal value of which is R100, payable in two years' time and on which interest of 10% will be levied. It is anticipated that future cash flows will total R100. It may appear that the loan is not currently doubtful. The current principal value of the loan is equal to the expected future cash flows. However, if the requirements of the National Credit Act are taken into account it becomes clear that the principal debt held by the taxpayer at year end will not be recovered.

Table 3: Example of interest accruing to a debt

	Year 0	Year 1	Year 2
Interest Accrued	-	10	5
Payments Received	-	58	42
Principal Debt	100	52	15
Expected Recovery	100	42	0

At the end of year 1 interest of R10 has accrued to the taxpayer and has been included as taxable income. Let us assume that debtor makes payments totalling R58. In terms of the National Credit those payments would first be applied to the R10 interest. The remaining R48 would only then be applied to the principal debt. At the end of year 1 the principal debt is therefore R52 and expected future cash flows are R42. A doubtful debt allowance of R10 may therefore be claimed in year 1.

In year 2 interest of R5 will accrue to the taxpayer and be included in their taxable income. As expected the debtor makes payments of only R42. These payments are applied first to interest leaving R37 to be applied to the principal debt. At the end of year the unimpaired principal debt amounts to R5 and future cash flows are R0. A doubtful debt allowance of R5 may therefore be claimed in year 2.

From the above example it is clear that a simple comparison of the outstanding principal debt and the expected cash flows is an insufficient estimation of the expected losses. The future losses identified at the end of year 0 were only claimed in year 1 and year 2 despite no deviations in the expected future cash flow occurring. It is an unnecessary burden that the taxpayer who has already paid tax on the full R100 is unable to claim relief where objective evidence indicates a pattern of payment which will fail to recover the full debt.

It is certainly true that the interest in the above example has not yet accrued to the taxpayer and is therefore not a "*debt due*." The interest is therefore not eligible for the doubtful debt allowance. However it is submitted that the estimated cash flows attributable to the primary debt cannot include amounts which in terms of the National Credit Act must be applied to interest. Those cash flows can therefore not be used to determine whether a debt has become doubtful.

5.3 Section 11(jA)

The method by which the Commissioner exercises his Directive will be replaced by section 11(*j*A). The new section is quoted in full below:

> *"(jA) notwithstanding paragraph (j), an allowance equal to 25 per cent of the loss allowance relating to impairment, as contemplated in IFRS 9, if the person is a covered person as determined by applying the criteria in paragraphs (c)(i) to (iii) of the definition of covered person in section 24JB(1): Provided that the allowance must be increased to 85 per cent of so much of that loss allowance relating to impairment as is equal to the amount that is in default, as determined by applying the criteria in paragraphs (a)(iii) to (vi) and (b) of the definition of 'default' as defined in Regulation 67 of the regulations issued in terms of section 90 of the Banks Act (contained in Government Notice No. R.1029 published in Government Gazette No. 35950 of 12 December 2012): Provided that the allowance must be included in the income of that person in the following year of assessment."*

The *Draft Explanatory Memorandum on the 2017 Taxation Law Amendment Bill of 19 July 2017* ("the Memorandum") makes it clear that the introduction of section 11(*j*A) is due to the replacement of the IAS 39 incurred loss model with the IFRS 9 expected credit loss model. The Memorandum states that the impairment requirements under IFRS 9 are "*determined on a significantly different basis from those under IAS 39*" which the Memorandum asserts will "*result in significantly higher levels of impairments being recognized, particularly in stages 1 (IBNR) and 2 (PSI)*."

In order to address this more substantial accounting provision for doubtful debts the following percentages are allowed as an allowance for doubtful debts in the banking environment:

Table 4: Comparison of allowances per section 11(jA) and the BASA Directive

	Allowances per proposed section 11(*j*A)		Allowances per BASA Directive
Impaired in terms of IFRS 9	25%	IBNR Impairment Provision	25%
Debtors measured at lifetime expected credit losses, but not in default.	40%	PSI Provision	85%
Debtors in "default"[122]	85%	SI Provision	100%

The new section 11(*j*A) does not provide the Commissioner with a discretion to determine the extent of a doubtful debt allowance. It is submitted that section 11(*j*A) would not constitute administrative action and would thus not be subject to the requirements of the Promotion of Administrative Justice Act. Section (*j*A) is not subject to section 117 (3) of the TAA. The proposed amendments come into effect on 1 January 2018 and will apply in respect of years of assessment commencing on or after that date. The removal of a Commissioner's discretion is one response to the impact of IFRS 9. Other possible responses are discussed in 6.4.

5.4 Conclusion

Although the Directive is applicable only to banks it provides insight into the Commissioner's understanding of the mechanics of section 11(*j*) and an indication of how the Commissioner will exercise their discretion in other industries. The Directive is clear in stating that the Act does not permit the Commissioner to substitute their discretion with an accounting standard. Nevertheless, because of the practical difficulty in evaluating every taxpayer's doubtful debts, the Commissioner will make use of *IAS 39* as the basis for their determination. By using *IAS 39* the Commissioner requires that all doubtful debts first meet the requirements of a doubtful debt for *IAS 39* purposes. This includes the requirement that for a debt to be impaired there must be a "*loss event.*" The Commissioner will then reduce the IAS 39 amount by a percentage which reflects the degree of uncertainty involved in the calculation. It is

[122] "*Default*" as defined in Regulation 67 of the regulations issued in terms of section 90 of the *Banks Act* (contained in Government Notice No. R.1029 published in Government Gazette No. 35950 of 12 December 2012)

submitted that where the historical figures provide evidence of the accuracy of the taxpayer's IAS 39 amount, the reduction applied by the Commissioner should be substantially reduced.

The interaction between the National Credit Act and section 11(*j*) was considered and it was determined that in estimating future cash flows, payments made by a debtor would be attributed first to the outstanding interest and then to the capital. It would therefore not be appropriate to include those cash flows in the calculation of a debt's recoverable amount.

Section 11(*j*) replaces the Directive by including fixed percentages in the Act. The Commissioner will not apply a discretion when determining doubtful debts for covered institutions. This amendment was the result of the increased uncertainty in estimating impairment amounts brought about by *IFRS 9*. IFRS 9 is discussed in more detail in the following chapter.

6 IFRS 9 and its impact on the allowance for doubtful debts

6.1 Introduction

In approaching the allowance to be granted under *IAS 39* "*the Commissioner has taken a more conservative approach*."[123] The Commissioner is certainly entitled to adopt this approach as the wording of section 11(*j*) requires that the Commissioner be satisfied. In contrast to the Commissioner's approach, the expected credit loss method contained in *IFRS 9* is not a conservative method. The aim of the standard is not to restrict the recognition of financial assets to only the most certain of recoverable amounts, an approach which the IASB notes would be preferred by some interested parties. Rather, it is to fairly represent the financial status of the entity. This purpose is defined by the IASB in the *Basis for Conclusions* of *IFRS 9* as:

> *"… [T]o be consistent with the Conceptual Framework, faithful representation of expected credit losses implies that the depiction of those credit losses is neutral and free from bias. The depiction of expected credit losses in an unbiased way informs the decisions of a broad range of users of financial statements, including regulators and investors and creditors. In the IASB's view, incorporating a degree of conservatism would be arbitrary and would result in a lack of comparability.*[124]*"*

Where two different foundational principles are used as the basis for the calculation of an amount there is bound to be a degree of tension. The IASB has, in addressing the failures of IAS 39 to provide sufficient warning to investors during the 2008 economic crisis, has created a standard which is forward looking rather than one based solely on historic events. IFRS 9 is based on estimates of future cash flows based on receivables in the aggregate rather than estimates of the cash flow of a particular debt. There may be an argument that it would be appropriate for tax legislation to adopt a more probabilistic approach which reflects the likelihood that a taxpayer will not receive funds from a debt. It is submitted, however, that the weight of case law and the opinion of the Commissioner are not in favour of this approach.

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[123] *The BASA Directive: 26*

[124] *IFRS 9 Basis for Conclusions:* BC5.86

The previous financial standard, *IAS 39 Financial Instruments – Recognition and Measurement*, was criticised as called "*too complex*" and "*inconsistent with the way entities manage their businesses and risks*."[125] The recognition of credit losses on loans and receivables was said to occur too late in the credit cycle.[126] It is the changes brought about by this last criticism that will be of most interest to the SARS and those seeking to determine the extent to which the SARS will allow a bad or doubtful debt allowance. The final version of the replacement standard, *IFRS 9*, was issued in July of 2014. *IFRS 9* is effective for all years of assessment with a starting date on or after 1 January 2018, although earlier adoption was permitted. The new standard is not industry-specific and applies to all entities. Non-financial institutions will have access to a practical expedient[127] which limits the amount of work required by the standard.

As discussed in 5.2.2, the impairment governed by *IAS 39* is based on 'incurred losses.' *IFRS 9* moves away from *IAS 39*'s "incurred loss" approach, in which an event needs to have occurred before an impairment may be claimed, to an 'expected credit loss' model. This chapter discusses *IFRS 9* as the replacement of *IAS 39* and considers the anticipated interaction between *IFRS 9* and section 11(*j*).

6.2 IFRS 9

IFRS 9 departs from *IAS 39*'s 'incurred loss' approach, in which an event needs to have occurred before an impairment may be claimed, to an 'expected credit loss' model. 'Expected loss' is a term borrowed from the field of statistics and means the total of all losses multiplied by the estimated severity of each loss.**[128]** An 'expected credit loss' is therefore the difference between cash flows due to an entity per the contract and the cash flows expected to be received discounted at the original effective interest rate. As no financial instrument can be said to have a 100% likelihood of recovery, all financial instruments will have some degree of

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125 *Pricewaterhouse Coopers*. 2017

126 *IFRS 9 Basis for Conclusions:* BC5.83

127 Refer to 6.3.2.

128 *International Risk Management Institute*: "Expected loss"

impairment allowance, even where there has been no observable evidence or 'loss event' pointing to a reduction in the likelihood of recovery.[129]

6.2.1 *The general approach*

IFRS 9 contains two approaches to the impairment of a financial instrument: the general and simplified approaches. Unless specifically identified, financial instruments will be subject to the general approach.[130] In the general approach, financial instruments are subject to two levels of impairment. Firstly, an impairment loss is recognised when the loan or receivable is recorded in the accounting books of the taxpayer.[131] The taxpayer should use all "*reasonable and supportable information which is available without undue cost*"[132] to determine the expected losses to be incurred over a 12 month period.[133] In allowing the use of all available information,[134] *IFRS 9* permits the entity to capture unobserved, but expected losses without creating a greater operational burden.

Secondly, where a significant increase in the credit risk of the financial instrument can be identified at year end the expected losses to be incurred over the lifetime of the financial instrument will form the basis of the anticipated impairment.[135] In determining whether there has been significant increase in credit risk all "*reasonable and supportable information which is available without due cost*" must be used.[136] There is a rebuttable presumption that where contractual payments are more than 30 days past due, the credit risk of a financial instrument has increased.[137] Objective evidence of an impairment is therefore not a requirement and an entity is not entitled to rely solely on historical information.[138] While significant guidance is

[129] *Pricewaterhouse Coopers*. 2017: 26

[130] *IFRS 9*: 5.5.15

[131] *Pricewaterhouse Coopers*. 2017*:* 29

[132] *IFRS 9*: 5.5.17 (c)

[133] *IFRS 9:* 5.5.5

[134] *IFRS 9:* 5.5.17 (c)

[135] *IFRS 9*: 5.5.3

[136] *IFRS 9:* 5.5.9

[137] *IFRS 9:* 5.5.11

[138] *IFRS 9:* 5.5.11

provided in *IFRS 9* it remains clear that an assessment of whether a significant increase in credit risk has occurred will require the application of substantial judgement.

6.2.2 The simplified approach

IFRS 9 provides for a simplified approach when dealing with trade receivables, contact assets and lease receivables. These financial instruments are often held by entities without sophisticated credit risk management systems. The simplified approach eliminates the 12 month expected credit loss calculation and the requirement to assess when a significant increase in credit risk has occurred. Instead, lease receivables, trade receivables and contract assets without a significant financing component have their loss allowance measured at initial recognition and over the life of the financial instrument at an amount equal to lifetime expected credit losses. A taxpayer may elect to measure the loss allowance trade receivables which do contain a significant financial component at lifetime expected credit losses upon recognition.[139] Entities are permitted to use a provision matrix as a practical expedient for the calculation of lifetime expected credit losses for these financial assets.

6.2.3 Credit adjusted method

If at the time of purchase or origination a financial asset is considered credit-impaired the general impairment model will not apply. Instead the loss allowance will be calculated on the lifetime expected credit losses of the financial asset. However, lifetime expected credit losses are included in the calculation of the effective interest rate of the asset on recognition. This means the effective interest rate on the financial asset recognized in the accounting books of the entity will be lower than the effective interest rate on a financial asset with the same face value. Consequently, no loss allowance is created at the initial recognition of the asset. This method is largely consistent with paragraph AG5 of *IAS 39*.

6.3 The determination of the impairment

6.3.1 Expected credit losses

Whether the simplified or the general approach is followed, expected losses must be calculated by identifying the probability of future cash flows expect in question. It is the aim

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139 *IFRS 9*: 5.5.15

of *IFRS 9* to present a "*faithful representation of expected credit losses.*"[140] The standard achieves a faithful representation by requiring an entity to:

> *"measure expected credit losses of a financial instrument in a way that reflects:*
>
> *a. an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;*
>
> *b. the time value of money; and*
>
> *c. reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions."*[141]

The standard requires the evaluation of a range of possible outcomes, however, it is not required that every possible scenario be considered. The standard does require at least two outcomes be considered, namely where a credit loss occurs and where no credit loss occurs, even where the possibility of credit loss occurring is "*very low*."[142] The complexity of this calculation is not prescribed by the standard and could comprise simple models or multiple scenarios specifying the amount and timing of various cash flows and their attendant probabilities.

IFRS 9, like *IAS 39*, explicitly includes the time value of money in the calculation of the present value of future cash flows.[143] The Commissioner, in the email to the Chairman of the Banking Association which accompanied the issue of the BASA Directive, made clear that:

> *"SARS has always been in disagreement regarding the adjustment for the present value of future cash flows in the calculation of the allowance determined in terms of section 11(j) of the Income Tax Act 58 (the Act). Be that as it may, allowing a further deduction for the net present value of future cash flows is against the general principle that a deduction is only allowable for an actual loss as opposed to a "loss" on the time*

[140] *IFRS 9 Basis for Conclusions: BC5.86*

[141] *IFRS 9: 5.5.17*

[142] *IFRS 9*: 5.5.18

[143] *IAS 39*: 63

value of money. The allowance available in terms of section 11(j) is already a very favourable tax dispensation in a banking context as the debt for which an allowance is being claimed has generally not been included in income. Hence, to now further extend such allowance to incorporate deductions that are not catered for in the Act is unacceptable."

The degree of judgement required for estimates is dependent on the availability of information.[144] The standard does not require detailed estimates of cash flows for periods far in the future. For such periods management may make extrapolations based on available detailed information. These factors combine to create an impairment standard which will incorporate more subjective estimates.

6.3.2 Provision matrix

When determining the expected credit losses on trade receivables, *IFRS* 9 allows for the use of a simplified 'provision matrix' as long as that provision is consistent with the general principles of expected loss measurement. The provision matrix is only available when the simplified approach is used. As such, the provision matrix is not available to financial institutions such as banks. The matrix uses historical default rates adjusted for forward looking estimates to determine the expected life of a trade receivable.[145]

Table 5: Example of a Provision Matrix

	Current	1-30 days past due	31-60 days past due	51-90 days past due	90 days or more past due
Calculated Default rate	0.3%	1.6%	3.6%	6.6%	10.6%
Carrying value	15,000	7,500	4,000	2,500	1,000
Lifetime expected credit loss	45	120	144	165	106

The change to the accounting standard will result in substantial changes to the manner in which taxpayers recognise impairments in their annual financial statements. While our courts

144 IFRS 9: 5.5.50.

145 *Pricewaterhouse Coopers*. 2017: 33

and SARS have both stated that accounting principles cannot simply be imported wholesale into the determination of tax allowances,[146] in the case of a provision for doubtful debts there remains a strong connection between the amounts recorded in the accounting records of a taxpayer and the amounts granted as a tax allowance. In an effort to alleviate the burden of investigating the doubtful debts of every taxpayer the Commissioner relies heavily on the accounting provision for doubtful debts.[147] Where the accounting principles required the presence of loss event the Commissioner was able to use the amounts recorded in the accounting books of the taxpayer and audited by external auditors as the starting point for the determination of a doubtful debt allowance. It remains to be seen how the Commissioner will approach the process of calculating a doubtful debt allowance where the accounting basis has abandoned the concept of a loss event.

6.4 Interaction with section 11(j)

6.4.1 Consequences of IFRS 9

Above I have noted that the application of section 11(*j*), as a practical matter, is directly linked to *IAS 39*, the accounting standard for financial instruments. I have further noted that *IAS 39* will soon be replaced by *IFRS 9*. I have noted that *IFRS 9* abandons the principle of a loss event being a requirement for an impairment of a debt, a principle which the Commissioner believes to be a prerequisite for the granting of a doubtful debt allowance. Below I summarise the consequences of the change in financial standard and the SARS' likely response:

6.4.1.1 ***Doubtful debt impairments will be based on a higher degree of uncertainty***

> *"[A]ny model that attempts to depict expected credit losses will be subject to measurement uncertainty."* [148]

This statement about the new impairment methodology from the IASB would presumably not have been well received by the SARS. The Commissioner's approach to uncertainty was discussed in 5.2.4 and can be summarised as, the greater the degree of uncertainty of

146 See *Stellenbosch Farmer's Winery Limited v CSAR 2012* (5) SA 363 (SCA) at para 35 discussed at 5.3.2.

147 The BASA Directive: 24 "*In order to facilitate a practical solution, the Commissioner will use the discretion, as provided for in section 11(j), in adjusting the IAS 39 impairment allowance for tax purposes.*"

148 *IFRS 9 Basis for Conclusions*: BC5.85

irrecoverability, the lower the doubtful debt allowance granted. By requiring the taxpayer to estimate the future tax flows on all debts regardless of whether or not a loss event has occurred will increase the amount of uncertainty in the calculation of doubtful debts.

6.4.1.2 ***Doubtful debt impairments will be recognised earlier***

It was the stated goal of the drafters of *IFRS 9* that likely impairments be recognised sooner than they had been under *IAS 39* in response to the criticism that *IAS 39* "*delayed the recognition of credit losses.*"**[149]** Impairments under *IFRS 9* can be based on "*reasonable and supportable information that is available without undue cost or effort about…forecasts of future economic conditions*"[150] and do not require the taxpayer to wait until there is "objective evidence that an impairment loss…has been incurred." [151] The taxpayer is therefore required to recognise impairments earlier than they would have been under *IAS 39*.

6.4.1.3 ***Doubtful debt impairments will be larger***

It is the expectation of taxpayers that the application of *IFRS 9* will result in the recognition of larger doubtful debt impairments.**[152]** An *Ernst & Young European survey* found that most banking institutions would see their provisions increase as a result of *IFRS 9*.**[153]** Perhaps more importantly, the Commissioner is of the opinion that the change in standard will result in greater loss allowances being claimed. On page 52 of the *Draft Explanatory Memorandum on the 2017 draft Taxation Law* Amendment *Bill***[154]** while providing reasons for the creation of section 11(*j*A)**[155]** the drafters of the Bill enumerate the differences between *IAS 39* and *IFRS 9*. They then go on to state that:

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149 *IFRS 9 Basis for Conclusions* :BC5.83

150 *IFRS 9:* 5.5.17(c)

151 *IAS 39:* 63

152 *Ernst & Young,* 2011: 15

153 *Ernst & Young,* 2011*:* 15

154 19 July 2017

155 Refer to 5.4.2

"[a]s a result of these differences, the adoption of the IFRS 9 accounting standard will result in significantly higher levels of impairments being recognised…"

Section 11(*jA*) will be applicable to only "*covered persons*" as defined in section 24JB of the Act. While the effect of the change to *IFRS 9* will have the greater impact on these financial institutions, all taxpayers will likely be forced to increase their impairments due to the removal of an incurred loss as a requirement.

6.4.2 The SARS' Response

As has been stated above the draft amendment to section 11(*j*) includes the concept of a government notice containing guidelines on how the allowance is to be applied. It is submitted that the adoption of IFRS 9 will be of particular concern to the SARS and that the content of this notice will be much influenced by that accounting standard. What then can we expect the SARS' response to be? Below I consider four possible responses.

6.4.2.1 *IFRS 9 impairments are accepted as tax deductible*

From the Directive we can see that the SARS is not averse to using accounting standards as a starting point for the determination of an allowance. There is some precedent for this in foreign jurisdictions. The Indian tax authorities accept that where a debt has been determined to be bad or doubtful in terms of an accounting standard that debt may be claimed as a tax allowance.[156] While this would certainly alleviate the practical burden on the Commissioner it is submitted that it is unlikely that this approach will be adopted. The presence of case law stating that the mere adoption of an accounting standard would not constitute an exercise of the Commissioner's discretion means that such an approach would likely not be accepted by the courts. Additionally, IFRS 9's forward looking approach to doubtful debts contrasts with the SARS interpretation that there should be a loss event before an allowance is claimed.[157] It is also unclear whether historical rates of recovery within the taxpayer's business would be

[156] *Pricewaterhouse Coopers*. 2016

[157] Refer to 5.4.3.2.

sufficient to claim a doubtful debt allowance in the absence of a loss event such as a debtor defaulting on a payment.

6.4.2.2 *IFRS 9 is accepted as a starting point and the 25% allowance rate is maintained*

The simple adoption of an accounting standard is an inappropriate method of applying the Commissioner's discretion. We have seen that SARS is willing to use an accounting standard as a starting point in its determination of a doubtful debt allowance. I submit that this approach remains unacceptable: applying a fixed percentage of an accounting standard is just as absent of an exercise of the Commissioner's mind. However, it is submitted that where the taxpayer is allowed an opportunity to submit information substantiating a different allowance rate the Commissioner will have applied their mind and the practice will be appropriate. It is possible that the same approach of the Commissioner using their discretion to apply a 25% rate could be maintained. It is submitted that this is highly unlikely.

6.4.2.3 *IFRS 9 is accepted as a starting point and the 25% allowance rate is decreased*

It is submitted that where the IFRS 9 accounting standard is accepted as the starting point it is more likely that an allowance rate lower than 25% will be used by SARS. Evidence of this approach can be found in the Taxation Laws Amendment Act No. 17 of 2017. That act included section 11(*j*A), discussed in chapter 5.4.2, which set out percentages which would be granted as impairment allowances for each of the categories of debt for 'covered persons' which were lower than the percentages which had been granted by the Commissioner in the Directive.

6.4.2.4 *IFRS 9 is not referred to when determining the tax allowance*

The Commissioner could abandon the accounting standard as a basis for determining the doubtful debt tax allowance entirely and require the taxpayer to compile a list of debtors for whom a loss event has been observed for which an allowance, most likely of 25%, could be allowed. This list of debtors is essentially the basis for the calculation of the pre-IFRS 9 doubtful debt allowance. The taxpayer will not be required to develop new debtor identification systems, but rather to maintain two separate systems: the current system and an IFRS 9 compliant system. This approach would have the benefit of keeping the allowance granted consistent with that granted in prior years and, for the Commissioner, of placing the burden of gathering information on the taxpayer.

6.4.2.5 ***Removal of the Commissioner's discretion***

On the 16th of July 2018, the 2018 Draft Taxation Laws Amendment Bill was released. The Bill proposed the substitution of the existing section 11(*j*) with the following paragraph:

> *"(j)(i) an allowance equal to 25 per cent of the loss allowance relating to impairment, as contemplated in IFRS 9, in respect of debt other than in respect of lease receivables as defined in IFRS 9, if IFRS 9 is applied to that debt by that person for financial reporting purposes; or*
>
> *(ii) an allowance equal to 25 per cent of so much of any debt, other than a debt contemplated in subparagraph (i), due to the taxpayer, that would have been allowed as a deduction under any other provision of this Part had that debt become bad if that debt is 90 days or more in arrears:*
>
> *Provided that an allowance under this paragraph must be included in the income of the taxpayer in the following year of assessment."* [158]

The Amendment Bill proposes the removal of the Commissioner's discretion from the determination of a doubtful debt replacing it with an allowance of 25% for IFRS 9 provisions for doubtful debts, or where IFRS 9 is not used, a 25% allowance for all debts 90 days or more in arrears. The Explanatory Memorandum on the Taxation Laws Amendment Bill, 2018 (Draft) released on 16 July 2018 notes that the 2015 amendment of section 11(*j*) which made provision for the replacement of the Commissioner's discretion with criteria set out in a public notice issued by the Commissioner has been unable to come into effect as the criteria for claiming the allowance for doubtful debts have not yet been formulated. The application of a simple 25% allowance places into legislation the current practice of the Commissioner. The proposed amendment will come into operation on 1 January 2019 and apply in respect of years of assessment commencing on or after that date.

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[158] *2018 Draft Taxation Amendment Bill 16 July 2018*: section 23(*e*)

6.5 Conclusion

The change from IAS 39 to IFRS 9 was caused largely by the failure of the former to adequately identify impaired financial instruments before the 2008 financial crisis. The new standard is stricter on recognising the possibility of impairments. Many non-financial institutions will use a simplified form of the standard which eliminates to the need to begin with a 12 month impairment assessment and then at year end to evaluate whether a significant deterioration in credit worthiness has taken place before applying a lifetime expected cashflow impairment. All taxpayers will need to apply the new expected credit approach which requires that taxpayers consider reasonable and supportable forward-looking information that is available as well as past events and current conditions when determining impairment. This would therefore include the possibility of future credit loss events when determining impairments. This new method would result in a greater degree of estimation being exercised by taxpayers.

The result of this new standard will likely be an increase in the size and timing of impairments as the accounting standard moves further away from the tenets espoused by the Commissioner as being vital to the recognition of a doubtful debt, primarily that a loss event must have actually occurred before an impairment may be recognized. It is expected therefore that the Commissioner will adjust the manner in which a doubtful debt allowance is granted, either through decreasing the 25% allowance or by requiring taxpayers to identify debts which have suffered actual loss events before granting an allowance only on those debts.

7 Conclusion

7.1 Introduction

This dissertation sought, through the consideration of legislation and case law, pronouncements made by the Commissioner in explanatory memoranda and sector directives, and academic writings, to answer the following four questions:

1. When will a debt be considered bad?
2. When will a debt be considered doubtful?
3. How is the allowance granted in terms of section 11(*j*) determined and how may the taxpayer challenge this determination?
4. How will the change from IAS 39 to IFRS 9 affect the process by which the Commissioner determines the allowance to be granted in terms of a doubtful debt?

7.1.1 When will a debt be considered bad?

Definition

There is no definition of a bad debt in the Income Tax Act. Case law informs us that whether a debt is bad is a factual question. All relevant circumstances must be considered with no factor a prerequisite for deduction. All relevant circumstances applicable to the specific debt under consideration must be considered. There is support in case law for the proposition that "*outside considerations*" are not applicable to the determination of whether a debt is bad, however it is submitted that where a debt is within a particular industry it is appropriate and necessary to include the extent to which debts are recoverable in a particular industry as a factor in determining whether a particular debt is bad.

Timing

The correct time to make a judgement on whether a debt is bad or not is at submission of the tax return. It is submitted that only information illuminating the situation of the debt as at the end of the year of assessment may be considered as the taxpayer must evaluate whether the debts has become bad during the year of assessment for which the tax return is submitted. Once the taxpayer has determined that a debt has become bad that debt may only be claimed in that year of assessment.

7.1.2 When will a debt be considered doubtful?

There is no definition of doubtful in the Income Tax Act. The ordinary definition of doubtful will apply. The Commissioner will determine whether they are satisfied that the debt is doubtful and the extent of the allowance to be granted to the taxpayer. A debt will only be doubtful where an event has occurred, casting doubt on the recoverability of the financial asset. It is not appropriate to use projections of future events as evidence that a debt is doubtful. The Commissioner may not rely on an external standard, such as accounting standards, to determine whether a debt is doubtful or not.

There is no clear dividing line between bad and doubtful debts. Where once they were used interchangeably, they are now separate concepts. There is not a point at which a debt stops being doubtful and starts being bad. A debt which is bad may also be doubtful where it meets the requirements of both sections.

7.1.3 How is the allowance granted in terms of section 11(j) determined and how may the taxpayer challenge this determination?

The Commissioner has a broad discretion to decide on the allowance granted. However, this discretion must be exercised in a manner which is procedurally fair, lawful and reasonable. In calculating the amount, the Commissioner will reduce the allowance granted proportional to the extent of the uncertainty inherent in the calculation. In order to fulfil the requirement of reasonableness, the allowance so granted should maintain a degree of proportionality with the doubtful debts determined. It is submitted that where sufficient historical data exists, the allowance granted should be equivalent to the historical rates. Where the link between the amount of the debt which is doubtful and the allowance granted is unreasonable in the opinion of the court, that court may remit the calculation to the Commissioner or alter the allowance granted itself. The Commissioner may not rely on practical expedients or generally expected practice to determine the allowance granted. The Commissioner may not rely on an external standard, such as accounting standards, to determine the extent of a doubtful debt allowance.

It is submitted that if the purpose of the provision for doubtful debts is to provide relief to the taxpayer in proportion to the amount of debts which have not been recovered the doubtful debt granted to the taxpayer should in general be equivalent to historical rates of recovery, where historical rates of recovery are relatively constant.

Where historical recovery rates are unavailable or unreliable, all possible information, both historical and forward looking, should be utilised to obtain the most accurate prediction of the extent to which debts will not be recovered. Currently, forward looking information is not permitted when determining doubtful debts. However, it is submitted that the amendment in section 18(1)(*j*) of the Taxation Laws Amendment Act[159] empowers the Commissioner to adopt new criteria for the evaluation of doubtful debt which may contradict case law as the wording and meaning of the section has changed. The new criteria must, however, constitute just administrative action.

For practical purposes it may be necessary for the Commissioner to establish a baseline allowance to be granted to the taxpayer in the absence of evidence provided by the taxpayer to substantiate different rates. It is submitted that historical recovery rates will in most circumstances provide evidence of the accuracy of a taxpayer's doubtful debt estimate without the burden of being required to collect additional data. Aligning with historical recovery rates is the simplest approach to ensuring that the allowance granted by the Commissioner is a reasonable administrative action as required by PAJA and the Constitution.

7.1.4 How will the change from IAS 39 to IFRS 9 affect the process by which the Commissioner determines the allowance to be granted in terms of section 11(j)?

Although the new accounting standard cannot affect the meaning of the Income Tax Act, the practical approach to the evaluation of doubtful debts adopted by the Commissioner is closely linked to IAS 39 and the principle that only incurred losses constitute indications of doubtful debts. A change in the accounting standard will mean that the Commissioner will either have to accept IFRS 9 as the new base, lower the baseline allowance of 25% of doubtful debts to account for an expected increase in doubtful debts per the new standard or require the

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taxpayer to keep a separate list of debts which would have been considered doubtful under the old IAS 39 standard.

New legislation has been passed which may negate the need for these approaches. The doubtful debt allowances of financial institutions, the taxpayers who will be most affected by the adoption of IFRS 9, will in future be governed by section 11(*j*A), a section which does not grant the Commissioner a discretion. Section 11(*j*) has been amended by section 18(1)(*j*) of the *Taxation Laws Amendment Act No. 25 of 2015* and will require a doubtful debt to be evaluated against criteria set out in a public notice. At the time of the writing of this dissertation the public notice has not yet been issued.

7.2 Areas for further study

While this dissertation has attempted to provide a comprehensive presentation of South African law surrounding bad and doubtful debts as at the end of 2017, there remain many areas of uncertainty to which further study may be applied. The following are suggested topics for further research:

- The interaction between income tax and value-added tax when a debt is determined to be bad;
- A comparison between South African law around bad and doubtful debts and the law of a foreign jurisdiction such as India, Canada or the United Kingdom;
- The tax consequences of the acquisition of a debtors book.

Of great interest will be the manner in which the proposed amendments brought about by the adoption of IFRS 9 will function in practice. In the coming years the following questions will provide grounds for further studies:

- Has the adoption of IFRS 9 resulted in greater bad and doubtful debt allowances being claimed?
- Has the adoption of IFRS 9 changed the manner in which the Commissioner evaluates doubtful debts?

- How do the criteria set out in the public notice referred to in section 18(1)(j) of the Taxation Laws Amendment Act No 25 of 2015 differ from the criteria set out in this dissertation?

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Annexure

The Letter to the Banking Asssociation of South Africa on the Treatment of Doubtful Debts on 17 February 2012.